Global Automotive Financial Review
An overview of industry data, trends and financial reporting practices*
2006 edition
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PricewaterhouseCoopers (PwC) is pleased to present its annual Global Automotive Financial Review – a summary of financial data, trends and practices as reported by leading global vehicle manufacturers and suppliers.

To assemble this eighth annual Financial Review, members of the PwC Automotive Practice analysed the annual reports and Form 10-Ks for fiscal years ending during 2005 and early 2006 for US registrants and annual reports for fiscal years ending during 2004 for non-US entities. Particular attention was paid to the chairmen’s letters to shareholders, management’s discussion and analysis (MD&A) and financial disclosures specifically relevant to the automotive industry.

The list of 37 companies included in this Review is presented as Appendices A (OEM segment information) and B (Tier 1 Supplier segment information). These companies consist of 17 global vehicle manufacturers and 23 global suppliers, 16 of which generated more than $10 billion each in revenue during 2005.

In the opening sections of the Review we summarise the industry’s 2004 results, future prospects, merger and acquisition activity and shareholder returns. We also present several articles prepared by members of our Automotive practice, summarising industry results and prospects in the BRIC countries, as well as on topics such as IFRS, Mergers and Acquisitions and Sarbanes-Oxley.
In the “By the Numbers” section, we present charts and graphs highlighting 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.

To provide additional insight into the priorities of the leaders of automotive companies, the “From the Chairman” segment provides quotations from the 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 opportunities in China and the Asia Pacific region, among others.

A summary of technical reporting issues of particular importance to automotive companies is also provided. With respect to guidance applicable to each topic, we provide representative quotations from financial statement footnotes to illustrate how automotive companies are dealing with these issues in their annual reports and Form 10-Ks. The disclosures presented are not offered as recommended methods of accounting or disclosure, but as illustrations of current practice. In addition, information is included on changes in accounting standards that are of particular relevance to automotive companies.

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.

*Consolidated Group Revenue
Global Automotive Sector Outlook: Big Bets and Shifting Competitive Dynamics

Light vehicle manufacturing growth

Global light vehicle assembly growth is expected to exceed 8.5 million units between 2005 and 2010, representing a 13.7% increase over the next four years. In fact, the PwC Automotive Institute forecasts double-digit growth rates in all global regions except North America. The largest contribution to overall growth is expected to come from the Asia-Pacific region, which is expected to account for more than 42% of the increase in vehicle assembly to the end of the decade.

Several mature markets are expected to grow over the next four years, including the US (9.5%), France (5.0%) and Germany (2.9%), but the biggest breakthrough will come from an emerging regional grouping we call the BRIC countries (Brazil, Russia, India and China). To put their collective growth in context, BRIC countries will account for more than 40% of the sector assembly increase over the 2005-2010 period, while representing 52% of the global capacity expansion in that time period. This is why nearly all major global automakers are pursuing a BRIC strategy in some form as they attempt to gain competitive advantage by tapping the potential of these emerging automotive markets.

On the surface, this growth might seem something to celebrate among global automakers and their suppliers.

Restructuring challenges

On the other hand, the last few years have brought numerous reports of financial instability, corporate bankruptcies, restructuring efforts and plant closures. In fact, massive structural changes are simmering, and the situation will only heat up as the entire automotive value chain struggles...
to adapt to new market realities. These include high raw material prices and razor-thin profit margins that put pressure on OEMs and suppliers alike – all against a backdrop of dramatic increases in the level of global competition. The result is a sector in which the players that have aligned with global trends will prosper, but new competitive intensity will increase the cost of mistakes.

Challenges that most OEMs face in their home markets include:

> Downward pressure on vehicle prices
> Supplier instability
> A relentless drive to improve shareholder value
> Mounting legacy costs
> Difficult labor relations.

Companies that maintain a “business as usual” posture, or those that have waited too long to act, will find it very difficult to sustain momentum as the competitive environment transforms around them.

Global expansion strategies

Historically, automakers have looked to global expansion as a way to generate incremental market share and profitability. However, this globalisation has led to increased levels of competition in almost every market around the world. As the industry becomes global and markets are divided up among more competitors, the greater the need for manufacturers to invest in new geographies in order to lower their individual market risk exposure and continue to grow. Indeed, globalisation is no longer a differentiating factor but a price of entry to remain truly competitive.

To date, successful emerging market strategies have depended on a company’s ability to extract substantial manufacturing cost savings from cheap domestic labour, while taking advantage of favourable exchange rates and, in many cases, generous government incentives. Among the global players leading this charge are Japanese and South Korean automakers, particularly Toyota Motor Company and Hyundai Motor Group. In the case of Toyota, the PwC Automotive Institute estimates global light vehicle assembly growth will approach 2.3 million units by 2010, representing 27% of overall industry growth and matching the increase expected for China as a whole. Hyundai is expected to post the most dramatic percentage growth of all the large OEMs, expanding its global footprint by 36% and looking almost exclusively at emerging markets to gain assembly volume.

Another interesting group of vehicle manufacturers are those companies that intend to grow beyond their regional or market-specific focus. Chinese domestic manufacturers such as SAIC, Geely, and Chery, for example, have been rapidly acquiring or developing intellectual property and

| Contribution To Light Vehicle Assembly Growth |
| 2005-2010 (%) – Top 10 Automaker Groups |
| Toyota | 26.7% |
| Renault-Nissan | 15.8 |
| Hyundai | 14.8 |
| VW | 12.3 |
| Fiat | 5.5 |
| PSA | 5.0 |
| Honda | 4.9 |
| DCX | 4.4 |
| Ford | 4.2 |
| SAIC | 2.1 |
| Total Industry Growth = 8.6 million units |

Source: PwC Automotive Institute
learning manufacturing best practices. Their understanding of global quality standards, supply chain management and efficient distribution channels will soon allow them to expand their individual reach into new global markets. In contrast, Indian automakers will have to find their footing independently because the Indian government does not require technology transfer as China’s does. The reality of new global players emerging from China and India is fast approaching and will only strengthen the need for industry consolidation in the mature markets of North America and Western Europe that likely represent key targets for these companies.

Capacity rationalisation efforts

Overall, although new global competition will provide fresh impetus for industry consolidation and rationalisation, the automotive industry has been carrying an unsustainable amount of excess capacity for a long time. Indeed, the cumulative pressure on some players has begun to outweigh their ability to resist change and has led to widespread restructuring efforts. Some North American manufacturers, for example, are starting to address their legacy issues more seriously, while reducing and realigning their production capacity footprint to better reflect their market share and competitive strategy. Although extremely painful, delicate and uncertain, labour dynamics and union relationships are being redefined in several mature markets around the world, an essential step in addressing the massive challenges of OEMs and Tier 1 suppliers. Early indications suggest that this recognition will eventually lead to a healthier playing field in the mid to long term, but the question remains whether some players have the time to adjust their businesses on so many different fronts.

Excess capacity and rationalisation are not unique to North America. The auto industry in the European Union is undergoing a similar restructuring; France, Germany, Great Britain and Spain are among the countries that have experienced plant closures as automakers continue to target eastern geographies for further expansion. These developments reflect a desire on the part of global OEMs to seek lower-cost manufacturing locations while simultaneously gaining a foothold in markets where significant future growth is expected (e.g., Czech Republic, Slovakia and Russia).

At the same time, excess capacity in emerging markets caused by over-exuberant investment strategies on the part of OEMs or suppliers looking for global growth is leading to an increase in exports to mature markets from major automakers in locations such as Brazil, China, Korea and Thailand. Faced with softening domestic demand and underutilised facilities, an easy solution for these OEMs is to turn on the export “safety valve” (provided currency exchange rates remain favourable). In Brazil, for example, some assembly plants over the past few years shipped products regionally and globally in increasing numbers – until Brazil’s currency, the real, began to appreciate.

Among the other factors that automotive companies take into account when evaluating a globalisation strategy are logistics and distribution costs, government relations, tariffs and quality of the local supply chain. In some cases, the availability of low-cost labor in a given market can be outweighed by the logistics costs involved in exporting vehicles or specific parts to global destinations. A global low-cost sourcing strategy also moves away from the just-in-time manufacturing paradigm and has the potential to heighten the risk of supply disruptions.

For this reason, decisions to globalise need to be made at the individual company and component level of detail. Among suppliers, these decisions are further complicated by the often-conflicting requirements put forward by their OEM customers. On the one hand, OEMs encourage
suppliers to relocate their operations to emerging markets for cost savings. On the other hand, proximate sourcing is becoming more and more important to address in-sequence assembly concerns and minimise the time it takes to implement design changes or correct supply errors. At the end of the day, suppliers are following their customers to low-cost locations around the world, but the risks should not be underestimated.

Automotive sector M&A activity

Those automotive enterprises that cannot successfully navigate these risks will not survive. In fact, several high-profile supplier bankruptcies demonstrate that the “cleansing” process has begun. At the center of this turmoil is a focused group of private equity firms whose interest in the sector continues to grow, fueled by:

- A massive amount of investment capital looking for a home;
- The perception of undervalued assets in the automotive space;
- The potential for dispassionate reorganisation aimed at extracting hidden profitability.

However, private equity players are becoming much more selective in their approach to this sector, having learned valuable lessons from disappointing early attempts. This Darwinian selection of suppliers is eventually leading to a stronger supplier body that has greater negotiating power with automotive manufacturers. Most players are well aware of the need for both critical mass and customer diversification. With more customers to approach and fewer competitors, suppliers are able to select the OEMs with which they want to do business and provide innovation, progressively reshaping the nature of their client relationships.

Automakers are responding by encouraging a more cooperative approach, as they come to realise that an overly aggressive stance on pricing, for example, could cost them a technological advantage over their competition – not to mention a potential supplier failure. This becomes important considering the increasing role suppliers are playing relative to overall R&D efforts. As global competition intensifies, automakers are looking to the supply base for any available technologies that will create competitive advantage.

Product proliferation

Manufacturers are also looking toward segmentation to create competitive advantage by better aligning with changing consumer tastes. The result has been a steady rise in the number of vehicles available in each global market as OEMs explore the limits of their product lineups.
in an effort either to maintain or grow their market share while maximising per-vehicle profit. One alarming example of product proliferation is the increasing number of luxury brands going down-market with sub-premium vehicles. This strategy requires not only significant R&D to bring these programs forward but also risks diluting established brand equity and alienating the traditional customer base. However, coupled with platform- and component-sharing initiatives, this product proliferation enables certain suppliers to increase volume and customer penetration even as it increases the complexity of the supply relationship.

Overall, the future of the industry carries many uncertainties. Not all automakers’ strategies are alike. Some are placing major bets on specific geographic growth, others on new vehicle segments or emerging technologies. Available resources will dictate how much an automaker can take advantage of opportunities in each of these dimensions.

With massive restructuring already under way, it is clear that both the OEMs and their suppliers are embracing change. While more difficult times lie ahead, strategies are starting to move beyond repairing outdated business models to building the foundations for a stronger sector.

PwC Automotive Institute
Key Political Risks and Opportunities for 2006

[ Brazil

] Economy

Inability by the federal government to form a stable majority in Congress and conduct fiscal reforms may contribute to only moderate economic growth, increasing risks of a continued stagnation of annual car production. The strong appreciation of the real in 2005 is likely to keep impacting exports, which are projected to increase by only 3% in 2006, compared with a rate of 34% in 2005.

] Trade

The probable re-election of President Luiz Inácio da Silva, popularly called Lula, will make it difficult for Brazil to make progress on new free trade agreements. The Lula administration is hesitant to open the economy further without significant concessions from industrial nations, and as a result, stalemates are likely to continue on multilateral trade negotiations. As a consequence, Brazil’s capacity to expand its export platform could suffer.

] Energy

Brazil’s self-sufficiency in petroleum, achieved in April 2006, and the extensive vehicular use of bio-fuels and natural gas will not exempt Brazil from the risks of fluctuations in fuel prices. Even though Petrobras can dilute upward pressures on gasoline over time, oil prices in Brazil follow international markets. Moreover, supply disruptions and price fluctuations are not uncommon in the domestic market of ethanol, which is added to gasoline (20%) and is also used in the growing number of automobiles equipped with flexible multi-fuel engines.

Source: Eurasia Group
The Brazilian Automotive Market

The Brazilian market represents one of the most challenging operating environments for global automotive manufacturers. Competitive intensity is exacerbated by:

> Excess capacity;
> Political and economic instability;
> Weakening consumer purchasing power and a lack of adequate consumer financing tools;
> High rates of taxation and interest.

In addition to these challenges, the value chains of many automotive assemblers are challenged by complex tax regulations, outdated labor regulations, a costly and fragile logistics infrastructure, rising commodities prices and an increasing number of “troubled” suppliers.

The automotive industry in Brazil grew quickly between 1992 and 1997, primarily as a result of economic stabilisation. This stability was brought about by a significant reduction in the rate of inflation, which led to a general increase in consumer purchasing power.

The stability also meant an increase in imports, which encouraged the modernisation of the automotive industry and paved the way for massive investments in local production capacity. From 1992 to 2002, an estimated $30 billion US was invested in the industry, primarily from foreign direct investments, and the number of original equipment manufacturers (OEMs) operating in Brazil increased from 9 to 17. The majority of the investments were made on the assumption that Brazilian market growth would exceed the growth forecast in the mature markets of North America and Western Europe.

However, the Brazilian market never reached the performance goals that had been forecast, resulting in an estimated 40% overcapacity in the vehicle assembly sector by the turn of the century. By 2003, the industry turned to an export strategy in an attempt to reduce this overcapacity while taking advantage of a weak Brazilian real. Until 2005, exports were the key to healthy short-term return on investment, but the rapid appreciation of the real by approximately 40% eroded that profitability. This currency appreciation issue illustrated the growing risk inherent in using exports to support assembly output. As export levels tend to decline with the stronger currency, Brazil requires a drastic rejuvenation in domestic market demand to continue upward momentum and ensure long-term industry stability.

Brazil Light Vehicle Assembly Outlook (1990-2013)

Source: PwC Automotive Institute
Prompted by a consumer focus on affordable vehicles, the domestic industry has emphasised production of small cars: in 2005, 55% of the vehicles sold in Brazil had 1.0 liter engines. These vehicles benefit from a tax incentive created in the early 1990s to promote environmentally friendly “popular” vehicles. Because this segment has very low margins and requires high assembly volume to absorb the manufacturing costs, it is fiercely competitive. Other segments including MPVs, SUVs and traditional sedans, where volume is relatively low but margins are higher, have produced the biggest gains.

The past year

In 2005, the Brazilian automotive industry produced approximately 2.2 million light vehicles, up nearly 11 percent from the record of 2.0 million set in 2004. Local sales increased 4 percent to 1.6 million units, but exports continue to account for an important share of vehicle production.

The assembly share of the top four domestic market leaders (Fiat, GM, VW and Ford) was essentially flat in 2005, while the shares of French and Japanese newcomers continued to increase, as a result of a focus on emerging segments and vehicle innovation.

The year was marked by continuing devaluation of the US dollar, started in 2004, which has already put prevailing export strategies at risk. Some contracts have been reduced while others have been canceled, with a general trend toward dramatically decreased profitability. Free trade agreement partners Argentina and Mexico remain the principal export destinations for Brazilian light vehicles.

Alternative fuel sourcing

A unique characteristic of the Brazilian automotive market is the predominance of flex-fuel engines, which run on gasoline, ethanol or any blend of the two. Vehicles powered by this technology were introduced in 2003, and sales have increased substantially in the past few years and currently represent half of new vehicle sales. This technology, first available on mainstream vehicles, is now available in all segments, encouraged by strong consumer demand.

The use of ethanol in Brazil dates to the 1970s, when government subsidies drove the development of the technology along with the establishment of refinement capacity and distribution channels. In the 1980s, ethanol-powered vehicles dominated the market, but fuel shortages late in the decade and falling gasoline prices in the 1990’s led many consumers to switch back to gasoline.

Today, soaring oil prices around the world are prompting many global markets to study the potential benefits of Brazil’s flex-fuel experience. Several automakers and flex-fuel technology suppliers are hoping to benefit from this increased level of interest by using the opportunity to export their vehicles, components or expertise.

The future

Despite the recent resurgence of domestic assembly and record levels of vehicle production, long-term market stability is far from certain. As with other regions, Brazil cannot sustain its position without robust local market demand – and this remains well below expectations. The rapid devaluation of the US dollar has highlighted for both industry players and government regulators this shortcoming and the associated over-dependency on exports.
A significant change in local market demand is unlikely in the near future. Market share ambitions from recent players such as Toyota or Honda are forcing the competition to update their vehicle portfolios, which may lead to higher transaction prices or a lower bottom line for traditional manufacturers. New product offerings tailored to emerging markets will increase the competition in the entry vehicle segment but will also create opportunities by opening the market to a new set of consumers.

Despite all the risks and challenges, Brazil continues to be a key market for global automakers in terms of both market potential and installed capacity. The exit costs are enormous, and so is the risk of missing future opportunities should the domestic market gain upward traction. At the same time, the assembly base in Brazil and other South American countries will have increasing competition from other regions. Improvement of the domestic Brazilian automotive industry will occur only if continued economic stimulation leads to rising domestic demand. Going forward, automotive companies must also have a well-defined, integrated supply chain strategy, supported by government investments for infrastructure, financing and tax breaks. For example, a structural change is needed to address the taxes levied on product development, as Brazil has one of the highest tax burdens in the world in this area. This single issue has the potential to undermine future investments in the country as automakers assess the viability of locating product development centers in the region.

Marcos Almeida
Marcelo Cioffi


Source: PwC Automotive Institute
| Economy |

The Kremlin in 2005 created special economic zones to stimulate foreign investment and economic development. Several automakers have proposed building facilities in the six approved zones, which offer lower tax and custom duty rates. In addition to this program by the national government, regional governments compete to attract foreign automakers through tax breaks and other incentives.

| Trade |

Russia remains on track for entry into the World Trade Organisation, despite difficult discussions with the US. Entry into the WTO will push Russia to gradually lower tariffs and trade barriers that hinder foreign investment in the automotive sector. At the same time, specific WTO requirements are likely to necessitate changes in the structure of future agreements between foreign automakers and local governments.

| Auto Policy |

While the government is working to attract foreign automotive investors, there have also been discussions of creating an even larger national automotive holding company – a role that might be filled by AvtoVaz, whose management was recently taken over by the state-controlled company Rosoboronexport. At the very least, AvtoVaz will be in a stronger lobbying position than foreign companies, given its close ties to Rosoboronexport and the state.

Source: Eurasia Group
The Russian Automotive Market

Dollar demand continues to surge, reflecting a transformation of the market structure

Russia’s automotive market is one of the most dynamic sectors of the Russian economy. In dollar terms, its value has increased over the last three years by an average of 27%, while in unit terms its growth has been a much more modest – 6.6% annually – reflecting a fundamental transformation of the market in favor of higher-quality, foreign-brand vehicles. This transformation is likely to continue for the medium term.

Two factors are driving the changes:

> The number of cars per 1,000 inhabitants remains considerably lower than that of mature markets. As the overall economy grows, the availability of consumer credit is rapidly increasing and the ownership base is growing steadily.

> As disposable income grows, existing car owners are upgrading to better-quality cars. According to one Economist Intelligence Unit estimate, personal disposable income will more than double between 2005 and 2010.

This market potential and government measures to stimulate foreign investments are attracting new players – so much so that the majority of major OEMs have announced various investment plans for Russia.

The market is expanding

Although growth slowed in 2005 from 2004, it remains steady and significant. In 2005, passenger car sales, including used car imports, reached $22 billion, up 19% from 2004. Unit sales, including imports of second-hand vehicles, rose 7% to 1.7 million vehicles.

The market’s growth in value terms was achieved by higher sales of new foreign models, led by Japanese and South Korean brands. The Hyundai Motor Group led the pack with passenger car sales of 110,000 units, up 60%, while GM, the Renault/Nissan Alliance and Ford had even sharper increases.

The market landscape is changing (in billions US)

New foreign models led the way, with growth of 36% in dollar terms. The growth rate of locally produced foreign brands has slowed, but the segment is expected to grow significantly as foreign investors further expand their capacity in Russia. The sales value of Russian brands grew by a meager 6% in dollar terms, reflecting price increases as local producers fight to cope with the impact of local inflation. The quantity of Russian-brand cars sold dropped 7.6% from 2004 levels. Sales of used imported light vehicles grew 14% in value.

The main factors behind growing demand remain income growth and development of the car loan sector. In the past five years, real disposable income per capita has been increasing 8% to 10% annually, according to the Economist Intelligence Unit, improving the buying power of the largest consumer segment, the middle class. Rapid development of consumer loans has had a similar effect; in 2005 alone,
the car-loan market tripled in size and as of January 1, 2006, amounted to $3.3 billion. Car manufacturers have found that loan programs appear to be the most effective means of attracting customers, and Ford, Nissan, Renault and AvtoVAZ have launched their own financing programs with attractive terms.

Changes in consumer preferences coincided with government measures to change the market structure even more. During the last three years, new foreign brands have been crowding out lower-quality cars; both Russian brands and second-hand imports.

Several factors contribute to this trend. Improved living standards led to a rise in spending on high-quality cars. At the same time, the increased prices of Russian brands eliminated the gap between Russian and foreign brands. As a result, demand for Russian cars is shrinking, as imported or locally produced foreign models grow in popularity. Against this background of increasing demand, favourable investment conditions stimulated development of local production by international carmakers. The share of foreign brands in local production output has grown strongly from a very small base.

In addition, an increase in import tariffs for second-hand cars in 2002 made imported used cars comparatively more expensive. So the share of new foreign cars in total imports volume increased from 20.7% in 2002 to 59% in 2005. Moreover, second-hand imports were replaced by the market for secondary sales of imported new cars.

**New players enter the stage**

Competition is getting tougher. Manufacturers are rushing to capture a niche in the middle-class segment, where demand now drastically outstrips supply. More and more international car-makers are announcing plans to open assembly lines in Russia. Those who have already started local production are working at full capacity and seeking to expand:

> In 2006 Ford increased production capacity of its plant in the Leningrad region to 60,000 units, investing about $30 million.

> Avtoframos, Renault’s plant in Moscow, will reach the planned production capacity of 60,000 by mid-2006, and Renault is thinking of further expansion.

> General Motors is expected to assemble three Chevrolet models, and possibly a fourth, with ZAO Autotor plant (Kaliningrad), in addition to other brands already produced there.

The growing interest of foreign companies in the Russian automotive market is helped by preferential import duties on auto components for car assembly projects. In 2005 the Russian government cut import duties for automobile components used for industrial assembly to 3%, from 12.5%. In the same year, agreements on industrial assembly of foreign vehicles in Russia were signed with IzhAuto and Severstal.
During the first half of 2006, investment agreements were signed with Renault, Nissan, VW and GM. While global automakers try to strengthen their positions in Russia, Chinese automotive companies are beginning to enter the market. Although Chinese sales are small (in 2005 their share was estimated at about 1% of the total market in units), their announced plans might, in time, threaten established market participants. Chery, FAW and Dadi have already begun local assembly.

**Chinese car production in Russia**

Chery Automobile Co. began assembly in Russia at the beginning of 2006. The company plans to invest $80 million to $100 million in the next two to three years and to expand its production capacity to 25,000 units. In April 2006 Autotor (Kaliningrad) started assembly of Chery brands. The company hopes to produce 17,000 cars by the end of 2006. Chery is also considering construction of a knock-down plant in Kaliningrad, most likely for export to Western Europe.

Great Wall, which led the sales of Chinese light vehicles in Russia in 2005, announced plans to invest more than $60 million in its Russian production capacity. Currently the company is looking for a site to build a 50,000-unit capacity plant. Construction is to be launched in 2006.

FAW produces the Tianye Admiral at the Altai plant in Biisk. The company is seeking a platform for its B-class passenger cars. FAW could also decide to apply for the industrial assembly program and to produce 30,000 to 50,000 cars a year.

Two Russian machinery plants agreed to set up production of models based on Dadi’s off-road vehicles (Dadi Shuttle). The Derways Automotive Company in Cherkessk established production in December 2005; the Zlatoust machinery plant announced its plans in March 2006.

Russia is seen as a good starting point for the Chinese because of the low barriers to entry. Chinese companies will likely target the lowest cost points, at the expense of Russian automakers. These Russian investments will also enable Chinese manufacturers to gain experience in running overseas operations. A Russian production base might provide the Chinese with several strategic advantages, as they compete in the low end of the Russian market, taking advantage of available raw materials, relatively cheap labour and scientific expertise, and at the same time establish an export or trans-shipment point for Chinese vehicle assemblers to access Western Europe.

**Outlook**

Further growth is expected in the market for new foreign cars in 2006. We will see total sales of vehicles increase by 2 million units, with new foreign car sales reaching 44% of the Russian market, compared to 33% in 2005.

Clearly, we stand at the beginning of an exciting battle, as competition heats up and market participants seek to strengthen their positions.

For now, a favourable economic outlook and demand for foreign brands makes Russia one of the most attractive regions for the auto industry. The PwC Automotive Institute predicts enormous growth of local production of foreign brands – by as much as 375% in the next five to seven years. To support this growth, more global suppliers are expected to invest in Russia. The increased competition will challenge Russian brands, and if current trends hold, the Russian brands will be forced out either by high-value global brands or cheap vehicles produced by Chinese and other ambitious manufacturers from developing markets. To maintain their market share, Russian producers need to revise price and quality strategies.

Stanley Root
A bill submitted to Prime Minister Manmohan Singh in May 2006, which enjoys strong support, would implement a comprehensive social welfare program for the poor. A social security tax would likely be imposed to help finance the program. Through raising taxes, the bill may also give the Congress Party more leverage to reform India’s rigid labour laws, which might benefit the automotive companies.

**Auto Policy**

The 2006-07 budget included a few changes. The excise duty on small cars was reduced to 6% from 24%, with the intention of making India a hub for small car manufacturing. This has given middle class consumers, who make up 22% to 24% of the general population, a golden opportunity to own a car. The government is expected to reduce taxes on large cars to 6% in the 2007-08 budget.

**Infrastructure Investment**

The government announced plans to expand its rural roads program and substantially increased funding. During the 2005-06 fiscal year, the budgetary allocation for rural road construction was up 50% over the previous year to Rs. 4200 crore. The program will link all unconnected living areas in the country, of which there are more than 1,000, at least half in tribal and hilly areas. The central government, however, will depend upon the states to carry out initiatives.

Source: Eurasia Group
The Indian Automotive Market

The importance of India’s automotive industry

The Indian economy is projected to grow by more than 8 percent in 2005-06, after steady growth of 8.5 percent and 7.5 percent in the previous two years. India has a burgeoning middle class of 350 to 400 million people and one of the youngest populations in the world – more than 890 million people are below 45 years of age. The current GDP of $650 billion (US) is expected to double by 2010.

The automotive sector is a very important component of the overall economy, representing approximately 4.2 percent of GDP, and has extensive direct and indirect links with several key areas of the economy. As a result, the industry has a strong multiplier effect and can be an important driver of growth.

Growth expectations

The Indian automotive manufacturing sector experienced steady growth with a Compounded Annual Growth Rate (CAGR) of approximately 12 percent from 2000-2005. Current light vehicle assembly volumes are projected to increase by an additional 51 percent over the next five years.

India Light Vehicle Assembly Outlook

The primary drivers for light vehicle assembly growth are:

> A graduation from two-wheeled vehicles to four-wheeled vehicles (currently two-wheelers constitute 77 percent of the production in the Indian automotive industry);
> A growing middle class population with rising income levels and greater disposable income;
> A stable economy;
> Growing urbanisation;
> Increasing popularity of owning a second vehicle in urban areas;
> Low vehicle penetration (current ratio of 6 cars per 1,000 people);
> Increased availability of financing at relatively low rates of interest;
> Price discounts offered by dealers and manufacturers.

Small cars represent the largest vehicle segment, accounting for approximately 70 percent of the passenger vehicle market. Future growth is expected to hinge on this segment, because of the vehicles’ fuel efficiency and low operating costs.
Overview of India’s automotive industry

Automotive facts

In the last budget, the Government identified the Indian automotive industry as one of five sectors expected to generate significant employment opportunities going forward. Some salient aspects of the Indian automotive industry are presented below:

> The automotive industry is comprised of light passenger vehicles, commercial vehicles, tractors, two-wheelers and three-wheelers.
The automotive industry provides direct employment for approximately 450,000 people.

With almost every major global vehicle manufacturer establishing assembly facilities in India, investment in the automotive industry was approximately $3.95 billion (US) in 2004-05.

Exports of auto components from India have grown at a record CAGR of 39 percent since 2001, and the trend appears to hold true for 2006.

The top five automotive companies, ranked according to assembly share (2005 & 2010) for the passenger car segment, are:

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<tr>
<th>Company</th>
<th>2005</th>
<th>2010</th>
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<tr>
<td>Maruti Udyog</td>
<td>48%</td>
<td>33%</td>
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<tr>
<td>Hyundai Motors</td>
<td>25%</td>
<td>25%</td>
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<td>Tata Motors</td>
<td>17%</td>
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<td>Honda Siel</td>
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<td>Ford India</td>
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</tbody>
</table>

Source: PwC Automotive Institute

New models

Competition is expected to intensify in the domestic market. Among the new models being introduced are:

| Fiat MPV      | Honda Civic | Toyota Fortuner |
| Fiat Panda    | Honda Jazz  | Toyota Hilux   |
| Ford Fiesta   | Hyundai New Accent | TML Crossover |
| Ford New Ikon | Renault Logan | Toyota Vios |
| Chevrolet Aveo | Tata New Indica |
| Chevrolet Spark |                      |

Existing original equipment manufacturers (OEMs) are expanding facilities and new OEMs, including BMW, Renault (in a joint venture with Mahindra & Mahindra) and Volkswagen are announcing plans to establish assembly plants in India. Indian OEMs have also begun exporting passenger cars to Europe, Russia and some ASEAN countries, a trend that is expected to increase in the future.

Auto components

The Indian auto component industry, with an annual output of $8.7 billion (US), has also witnessed double-digit growth with a CAGR of 17 percent over the last eight years. Of that $8.7 billion, $1.4 billion constitutes exports, mainly to the US and Europe. The Indian auto component industry has shifted focus from the global aftermarket to becoming original equipment suppliers. Studies indicate that the Indian auto component industry has the potential to increase its share of the global auto component business from 3 percent to approximately 7 percent, which would represent an additional $33 billion to $40 billion. The auto component industry has been focusing on operational excellence to improve quality and reliability; more than 330 companies have ISO 9000, ISO 14001 and QS-9000 certifications.

Auto component production range

Source: ACMA
Specific skills

India offers an excellent base for information technology-oriented engineering solutions. As a result, companies are increasingly establishing design and research centers in India, which is emerging as a vibrant and a competitive design/development and engineering hub, in addition to its established role as a low-cost global sourcing destination. For example, DaimlerChrysler is looking at upgrading its Indian research and development laboratory into an engineering center that will focus on generating lower costs and increasing technical expertise. Expected to take three years to establish, the engineering center will focus on CAD/CAM and computing analysis in order to leverage domestic technical and engineering expertise.

Role of the Government

The Government has also reduced the rate of excise duty on the manufacture of small cars, which are defined as having engines with a maximum displacement of 1,200 cc and an overall length under four meters. The intention is to project India as a global manufacturing hub for small cars. Auto manufacturers like Maruti, Hyundai and Tata will benefit from this tax reduction. The Government has already taken several steps to facilitate growth in the automotive industry, including reduction in levels of duties, higher allocation for infrastructure projects and establishing vehicle test facilities.

Challenges

Challenges in the Indian automotive sector include inadequate infrastructure, rising input costs, government corruption and bureaucracy and a high level of corporate taxation. Other challenges include inconsistent government policies at the state level, low levels of investment in product and technology development and relatively strict emission regulations. Competition will also intensify as more players enter the market. The Government of India is actively pursuing free trade agreements with neighboring countries, including those in the ASEAN region, though it should be noted that these agreements might place Indian companies at a disadvantage because India currently has one of the highest tax structures. At any rate, these agreements will place further pressure on Indian companies to be more cost competitive going forward.

Indian automotive companies also need to increase investments in developing and acquiring new technologies to meet global auto standards. Investing in robust technology will enable Indian auto manufacturers to provide best-in-class products to Indian consumers and compete effectively in world markets as Indian car exports continue to rise. Consumers are also placing pressure on companies, resulting in increased manufacturing complexities despite low volumes.

The automotive industry will need to work closely with the government to address these challenges and leverage advantages in order to market the “Made in India” brand.

Abdul Majeed
Ramesh Rajan

### Additional Data on the Indian Automotive Market, Automobile Production (in thousands)

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<tbody>
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<td>513</td>
<td>564</td>
<td>609</td>
<td>842</td>
<td>961</td>
<td>1046</td>
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<tr>
<td>Multi-utility vehicles</td>
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<td>106</td>
<td>112</td>
<td>146</td>
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<td>263</td>
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<td>Commercial vehicles</td>
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<td>163</td>
<td>204</td>
<td>275</td>
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<td>4271</td>
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<td>Three-wheelers</td>
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<td>213</td>
<td>277</td>
<td>341</td>
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<td>Total</td>
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<td>5316</td>
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<td>7229</td>
<td>8468</td>
<td>9735</td>
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<tr>
<td>Percent Growth</td>
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<td>(2.00)</td>
<td>11.7</td>
<td>18.60</td>
<td>15.12</td>
<td>16.40</td>
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### Automobile Export (in thousands)

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<td>23</td>
<td>50</td>
<td>71</td>
<td>126</td>
<td>161</td>
<td>170</td>
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<td>Multi-utility vehicles</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>1</td>
<td>3</td>
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<td>14</td>
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<td>17</td>
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<td>Three-wheelers</td>
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<td>43</td>
<td>68</td>
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<td>77</td>
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<tr>
<td>Total</td>
<td>140</td>
<td>168</td>
<td>185</td>
<td>307</td>
<td>479</td>
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<td>806</td>
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<tr>
<td>Percent Growth</td>
<td>(12.18)</td>
<td>20.24</td>
<td>9.74</td>
<td>65.35</td>
<td>55.98</td>
<td>31.25</td>
<td>28.11</td>
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Source: SIAM

### Road Map of Transition of Emission and Safety Regulations for Vehicles in India

<table>
<thead>
<tr>
<th>Year</th>
<th>Emission Regulation</th>
<th>Safety Regulation</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Metro Cities</td>
<td>Rest of Country</td>
</tr>
<tr>
<td>2000</td>
<td>BS 2 (Euro II)</td>
<td>BS 1 (Euro I)</td>
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<tr>
<td></td>
<td></td>
<td>Underbody protection devices, advance warning triangles</td>
</tr>
<tr>
<td>2005</td>
<td>BS 3 (Euro III)</td>
<td>BS 2 (Euro II)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Spray suppression, noise norms, headlamp levelers</td>
</tr>
<tr>
<td>2009</td>
<td>BS 4 (Euro IV)</td>
<td>BS 3 (Euro III)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ABS, pedestrian protection (Expected)</td>
</tr>
</tbody>
</table>
China will continue efforts to rein in the economy after government concerns of excessive overheating in the first half of 2006. To achieve this goal, Beijing is likely to continue its steps to keep the currency flows from its large trade surplus from affecting the domestic money supply and raising the risk of inflation. These steps might include raising the prices of energy and other inputs and administratively restricting investment in sectors with overcapacity, including, possibly, the automotive sector.

Trade

China is currently negotiating free trade agreements with the Gulf Cooperation Council and Australia, two of its largest natural resources trade partners. Both agreements are expected to be signed by the end of 2007 and will give China stable access to critical energy and mineral resources.

Source: Eurasia Group
Growth recovers in late 2005 and carries through 2006

In 2005, the Chinese automotive industry experienced moderate growth after the sharp slowdown in 2004. Vehicle production rose 19.3% to a record 4.36 million light vehicles, making China the fourth largest auto producer in the world following the US, Japan and Germany. In 2006, China is expected to overtake Germany as the third largest assembler of light vehicles in the world but not to supplant Japan’s position at No. 2. Last year, the Chinese automotive market represented 8.7% of the global market and contributed 23.2% of the total growth of the global automotive industry, clearly taking a centre stage position in the global markets.¹

The moderate growth in 2005 reflects:

> The Chinese economy continued to grow at a rapid pace, posting 9.9% growth in 2005 and 10.2% in Q1 2006. Urban incomes continue to rise, up 15%. The rising incomes have boosted households’ spending power, with retail sales up 12.8% through March 2006. Fixed investment was up 27.7% in Q1 with investment in both domestic and export-oriented manufacturing and infrastructure development. The National Bureau of Statistics of China announced that the country now boasts 50 million people in the “middle class”, which is defined as those individuals earning $7,400 to $14,800 US annually. The number is expected to triple by 2010, representing the fundamental driver of sustainable growth in the domestic automotive industry.

> Second- and third-tier cities grew at an impressive pace in 2005, and auto sales grew by around 40% in central coastal markets such as Jiangsu, Zhejiang, Shandong and Guangdong. Sales are also estimated to have grown by 50% in third-tier markets in inland provinces.

> Sales results indicate that consumers have shifted their focus toward economical vehicles. Cars are no longer solely the symbol of social status; “cut-throat” price wars have brought the price of vehicles down to a more affordable level.

Key players in the market

The automotive market continues to be dominated by global players, including Japanese and South Korean brands that have increased their collective market share sharply in the past few years.

China Light Vehicle Outlook by Alliance Group
(2004 vs. 2005 vs. 2013)

Source: PwC Automotive Institute
In terms of individual OEMs, General Motors posted the highest growth, solidifying China’s importance in GM’s global growth strategy. Chinese domestic manufacturers are also doing well in the small car, minibus and SUV segments.

**Alliance Group Contribution to Growth**  

<table>
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<tr>
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<tbody>
<tr>
<td>PSA</td>
<td></td>
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</tr>
<tr>
<td>Chery Auto</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Renault-Nissan</td>
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<tr>
<td>Harbin Hafei</td>
<td></td>
<td></td>
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<tr>
<td>Ford Motor Co.</td>
<td></td>
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<tr>
<td>China FAW</td>
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<tr>
<td>Honda</td>
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<td>Toyota</td>
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<tr>
<td>Chang’an</td>
<td></td>
<td></td>
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<tr>
<td>Hyundai</td>
<td></td>
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</tr>
<tr>
<td>Volkswagen</td>
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<td></td>
</tr>
<tr>
<td>General Motors</td>
<td>20%</td>
<td>28%</td>
</tr>
</tbody>
</table>

Source: PwC Automotive Institute

**Key aspects of the Chinese automotive industry in 2005**

**Chinese domestic automakers are benefiting from a shift toward economical vehicles:**

> Foreign joint ventures have ceded significant share to Chinese OEMs in the SUV sector where, like other segments, competition is based almost exclusively on price.

> Some joint ventures will be exposed to significant risks as the market shifts away from the dominant mid-size and large-car segments.

> At the same time, domestic brands are pressuring foreign OEMs to find an up-market “safe harbour”.

> Going forward, the key sales battleground will be the small car segment, where policy undercurrents strongly favor domestic automakers.

> The Chinese “Big 3” has significant market advantages, but they may find it difficult to compete in small cars, because of their cost structures and because their bureaucracies prevent rapid changes in adapting to market conditions.

> In contrast, the smaller domestic automakers are better suited to respond, because they are still in their early development and quite flexible.

**Assembly Share by Segment**

<table>
<thead>
<tr>
<th>Segment</th>
<th>Chinese Domestic</th>
<th>Joint Venture</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minibus</td>
<td>66</td>
<td>34</td>
</tr>
<tr>
<td>SUV</td>
<td>44</td>
<td>56</td>
</tr>
<tr>
<td>Small Car</td>
<td>43</td>
<td>57</td>
</tr>
<tr>
<td>MPV</td>
<td>34</td>
<td>66</td>
</tr>
<tr>
<td>Large Car</td>
<td>3</td>
<td>97</td>
</tr>
<tr>
<td>Mid Car</td>
<td>1</td>
<td>99</td>
</tr>
</tbody>
</table>

Source: China Business Update
Export of automobiles and auto parts continues to grow:

> In 2005, demand for imported automobiles and parts decreased while exports soared. Statistics from the Custom House show that imports of automotive and related products increased by only 1 percent, totalling $15.2 billion US while exports reached $19.5 billion US, representing a year-on-year growth of 56%. In particular, exports of assembled vehicles grew by 160% to $1.6 billion. Auto parts, accessories and bodies increased by 52% to $8.5 billion. More and more global automakers such as GM and Ford view China as an ideal source for low-cost suppliers, leading to the sharp growth in exports. Moreover, Chinese exports to markets such as Iran, Nigeria and the United Arab Emirates reached $1.3 billion US in 2005.

Consumer behavior is changing

After five years of rapid growth in the automotive industry, Chinese consumers have become more mature. Where vehicles were once considered “symbols of social status” they have largely become a means of transportation.

> Large vehicles are no longer favoured by the market as a direct result of soaring fuel prices. Fuel economy has become the major concern when consumers plan for their first car. Consumers have also started to look to diesel and hybrid vehicles as viable alternative choices.

> Consumer perceptions toward small hatchbacks are also starting to change. Traditionally, larger sedans were the only “real” vehicle type. This change in attitude has been driven by the dramatic increase in the numbers of vehicles on the road, a decline in available parking spaces in urban markets and the relaxation of driving restrictions for these types of vehicles in city centres.

> Consumers have started to trust domestic vehicle brands. Traditionally, the commercial vehicle segment has always been dominated by local automakers, while the passenger vehicle segment has been dominated by global automakers. Thanks to the continuous efforts of domestic automakers such as Chery, Geely and Brilliance Auto, Chinese consumers are considering local brands.

> Used vehicle sales have increased following the implementation of the Regulation on Sales of Second-hand Vehicles in October 2005.
Profit of auto automakers is declining

In 2005, declining transaction prices adversely affected automaker profitability in China, contributing to overall profit erosion.

OEMs are also facing:
> Rising raw material costs;
> Increased competition – more than 100 nameplates currently in an increasingly crowded market.

Profitability in the Automotive Sector
(2002-2005)

Although production and sales soared in 2005, total automotive industry profit decreased by 38.4%, following a decrease of 18.3% in 2004. The net profit rate decreased from 9% in 2003 to 4% in 2005 and is now lower than the average profit rate for the manufacturing industry.

The outlook for 2006

The Chinese auto market remained on the fast track in the first five months of 2006. Passenger vehicle production and sales reached 2.2 million and 2.1 million units respectively, representing sales growth of 39% compared with the same period last year. However, considering the strong finish in 2005, this growth rate is not likely to be sustainable for the rest of 2006. We estimate the industry will grow by 24% with production reaching 5.43 million units, while capacity utilisation will increase to 67%.

Wilson Liu
Colin Zhang

Source: China Economic Information Service

1. Source: PricewaterhouseCoopers Automotive Institute
Merger and acquisition activity in the global automotive sector rose in the first half of 2006, as trade buyers returned to deal-making.

As raw material prices have surged, an increasing number of distressed asset sales seems likely, creating opportunities for consolidation led by both stronger trade buyers and restructuring specialists. A number of private equity firms are grappling with problems arising from unforeseen cost increases, and hedge funds are emerging as a powerful new force in automotive M&A, buying debt from banks and spurring more radical action, including forced disposals, than has historically been the case.

In 2005, Europe remained the most active region for automotive M&A, and Asia continued to live up to its promise as a new source of consolidation. Chinese and Indian companies, in particular, were buoyed by booming home markets, cash reserves and favorable ratings and are either picking up bargains among Europe’s distressed automotive assets or entering competitive auctions.

**Vehicle manufacturing sector**

In the relatively stagnant vehicle manufacturing sector, signs of deal activity emerged, as some manufacturers trimmed their existing portfolios by selling non-core activities.

The days of big mergers between vehicle manufacturers are over; the manufacturers prefer cooperation and cross-shareholding with their rivals. They have concluded that the mega-deals of the past years failed to deliver the anticipated synergies and did not address the industry’s central problem, overcapacity.

Deals in the sector are of two distinct types: on the one hand, share stakes are being built among the major global vehicle manufacturers; while on the other, true change-of-control transactions are focused on smaller niche specialists, spanning everything from motorcycles to trucks and tractors.

Emerging players were the focus of a significant number of transactions in the vehicle manufacturing sector, accounting for four of the top ten deals in 2005. Chinese groups completed two significant deals (Shanghai Automotive Industry Corporation's acquisition of South Korea’s Ssangyong and Nanjing’s purchase of MG Rover of the UK), while there is an ongoing shuffle of assets in Russia. If GM or Ford move to dramatically refocus, players in South Korea, China and India could be the movers and shakers.
Emerging markets are providing some of the most interesting growth stories, as companies benefiting from rapid growth in Asia now eye acquisition opportunities in Europe, seeing M&A as a means both to plug gaps in technology and to develop their distribution networks.

Chinese companies are looking at distressed situations, as in Nanjing’s acquisition of MG Rover, and Indian vehicle manufacturers are becoming a force to be reckoned with.

Last year, cash-rich Indian vehicle manufacturers featured in a number of potential bid situations, using their ability to source components much more cheaply than their established Western rivals as a competitive edge.

Vehicle manufacturers continue to monetise non-core, highly rated assets, and as they do, a variety of buyers find a slew of opportunities. While manufacturers regard vehicle design, manufacturing and distribution activities as core, all other activities are up for grabs, particularly those that will fetch a premium. The result has been a range of disposals, from components operations (VW sold Bordnetze, a wiring harness operation, to Sumitomo) to rental (Ford sold Hertz to a private equity consortium) to financial services (GM is selling GMAC to Cerberus, a private equity group).

Private equity groups have already shown they are willing to take on non-core activities in the components sector. Vehicle manufacturers have historically viewed this sector with caution, and private equity groups are now demonstrating that they are the “buyers of choice,” ready to pay the highest prices. Deals such as EQT’s acquisition of the DaimlerChrysler Off-Highway business and Patriarch Partners purchase of the same group’s fire and rescue vehicle operations underline the trend.

Components sector

In 2005, the number of deals in the components sector rose more than 20%, though deal value rose more slowly. The biggest development in the last 18 months was the re-emergence of trade buyers. In the first half of 2006, the five largest deals were all undertaken by trade players. Private equity involvement cooled during the first half of 2006, accounting for 14% of deal value, compared with nearly 30% in 2005 and 61% in 2004.

In 2003 and 2004, private equity buyers were able to pick up assets at low multiples, as the sector was unloved and trade interest was at an all-time low. Today, with the stock markets more buoyant and banks offering much more aggressive debt multiples, trade players from both developed and developing markets are becoming more daring. Valuation multiples have risen substantially, and many private equity groups have become more selective, focusing on niche businesses with strong margins, strong market shares and potentially more defendable market positions.

Among the significant deals in the components sector were Nippon Sheet Glass’s purchase of Pilkington, Johnson Electric’s acquisition of SAIA Burgess, BorgWarner’s purchase of a controlling interest in Beru, Valeo’s acquisition of both Engle and Johnson Control’s Engine Electronics, and Honeywell’s purchase of First Technology.

Europe remains the focus of deal activity. Problems at the Big 3 in North America have caused a significant slowdown in M&A activity, with no end to the problems in sight. One area that is likely to see activity is distressed M&A, as some of the big names in the US components sector continue to restructure.

Deal volume in emerging markets, particularly BRICs, is steadily increasing. The top ten deals by value do not
reflect this, but the activity is readily visible in mid-market auctions. Indian groups, in particular, are targeting Europe, while Chinese groups have their eye on North American assets, where supply lines are shorter and the obsession of the Big 3 with securing low-cost supplies plays to Chinese strengths. While the deal value associated with such moves is currently quite small, we are convinced this will change in coming years.

The emerging market groups are benefiting from fast profit growth. While the capital expenditure required to keep pace is high, the attraction of acquiring technical expertise and new customer relationships makes these acquisition opportunities very hard to resist.

In the components sector, bids have ranged from under 4x EBITDA to more than 7x EBITDA. The key differentiator is future prospects, not current profitability. We have seen different businesses with EBITDA margins of 10-12% attract vastly different valuation multiples. What this demonstrates is that each deal needs very careful analysis by prospective buyers, to ensure they neither over-pay nor suffer the disappointment of being unnecessarily outbid. Every deal must be approached in a rigorous manner, with all risks and opportunities carefully assessed.

Distressed situations are also becoming more common in the components sector. Soaring raw material prices (plastics, aluminum and steel have all increased dramatically) have caused problems in many groups. This has been particularly evident in the aluminum die-casting sector, where a number of groups have seen profitability decimated when raw material price increases could not be passed on. This created havoc among highly leveraged, private equity backed entities, many of which have now broken banking covenants. A perilous downward spiral may ensue. Hedge funds that buy debt from banks and distressed equity have also, in some cases, become activists for change, spurring both debt and equity write-offs.

This, in turn, may promote more aggressive management action, the appointment of turnaround specialists, interim management, or, in extreme cases, sell-side advisers to explore the potential to sell or break up businesses.

New consolidators are also appearing. In the past, consolidation was the preserve of trade players, but private equity groups are becoming more interested in a buy-and-build strategy. Although this was tried and in some cases ended in tears in North America (witness Citation, Collins and Aikman and Oxford Automotive), a number of players in Europe are undeterred. Wilbur Ross, the US investor, reversed his stake in Oxford Automotive Europe into metal pressed parts specialist Wagon (giving him a major equity stake in Wagon in the process) and is aiming to take the combination forward through further deals. Polytec, Plastal and Key Plastics, which are all private equity-backed, are actively pursuing buy-and-build strategies in the European auto plastics sector (where consolidation is essential if survival is to be assured).

Despite all this activity, overall consolidation in the automotive components sector has not progressed as fast as many had anticipated. Private equity buyouts and the shuffling of assets between buyout groups, in secondary and tertiary deals, does little to reduce supplier numbers. Rapidly growing groups in the emerging markets are also boosting the numbers of meaningful industry players.
Retail, aftermarket, rental/leasing and wholesale

This conglomeration of sectors saw a boom in deal value in 2005, largely because of the $15 billion purchase of Hertz from Ford by a consortium of private equity investors. At the time, this was the second largest buyout in history, behind KKR’s acquisition of RJR Nabisco in the 1980s. And the Hertz deal proved to be no aberration. In the first half of 2006, Eurazeo bought Europcar from Volkswagen in a deal worth nearly $3.7 billion. In 2005 and the first half of 2006, private equity led three of the five largest deals.

Private equity groups are attracted to these service-sector opportunities because they are by and large less capital-intensive than most other areas of the auto universe – and, as a result, a substantial proportion of the cash flow is available to service debt. The secondary buyouts of Kwik-Fit by PAI and Autodistribution by Investcorp underline the interest.

The other significant trend is the continuing consolidation of the UK retail sector. The boldest moves to date have been made by Pendragon, but other players in the UK’s Top 10 will ultimately have to acquire or they will be acquired; the consolidation has a long way to run. In mainland Europe, the car retailing market is much more fragmented than in the UK, so while deal volume may accelerate, deal value is likely to remain fairly modest for the next five years or so.

Private equity – interest waning

Private equity firms accounted for a dramatically lower proportion of deal value in the automotive sector as a whole in 2005 and the first half of 2006, compared with 2004. The private equity share of total automotive deal value was 57% in 2004; it fell to 22% in 2005 and 23% in the first half of 2006.

The declining interest of private equity is most striking in the components sector. In 2004, private equity accounted

### 2005 Automotive M&A Activity by Sub-Sector

<table>
<thead>
<tr>
<th>2005</th>
<th>Deal Value ($m)</th>
<th>Total Number of Deals</th>
<th>Average Disclosed Deal Value ($m)</th>
<th>Number of Disclosed Deals</th>
<th>Number of Disclosed Deals as % of Total</th>
<th>% of Total Deal Value</th>
<th>% of Total Number of Deals</th>
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</thead>
<tbody>
<tr>
<td>Vehicle Manufacturer</td>
<td>6 847.8</td>
<td>77</td>
<td>180.2</td>
<td>38</td>
<td>49.4</td>
<td>16.9</td>
<td>13.2</td>
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<tr>
<td>Component Supplier</td>
<td>10 261.3</td>
<td>249</td>
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<td>Retail</td>
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<td>Rental / Leasing</td>
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<td>21</td>
<td>65.9</td>
<td>15</td>
<td>71.4</td>
<td>2.4</td>
<td>3.6</td>
</tr>
<tr>
<td>Total R,A,R/L &amp; W*</td>
<td>23 499.8</td>
<td>257</td>
<td>228.2</td>
<td>103</td>
<td>40.1</td>
<td>57.87</td>
<td>44.08</td>
</tr>
<tr>
<td>Total</td>
<td>40 608.9</td>
<td>583</td>
<td>146.6</td>
<td>277</td>
<td>47.5</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Thomson Financial and other publicity available Sources.

* R,A,R/L & W = Retail, Aftermarket, Rental / Leasing & Wholesale
for 61% of the deal value; in 2005 that fell to 29%, and in the first half of 2006 private equity accounted for only 15% of deal value.

By contrast, private equity has increased its participation in the aftermarket sector. The leveraged buyouts of Hertz and Europcar pushed up the overall value of global M&A in the automotive sector through 2005 and the first half of 2006 and highlight the push by many private equity firms toward larger and larger deals.

While private equity has by no means abandoned the mid-market, most players have become very selective there. In the components sector, many businesses that would previously have attracted interest from private equity are struggling to find buyers. This, in turn, has widened the range of valuation multiples being offered, with premium multiples reserved for niche players. Commodity players are struggling to find offers even at net asset value.

Private equity investors have taken center stage as the leading deal drivers in automotive M&A, with mixed results. Having dominated certain niches in the components sector, private equity firms have now focused on new growth areas characterised by high margins, low levels of regulatory intervention and exposure to the booming aftermarket sector. This reflects the hard lessons offered by the components sector last year, when the spiraling cost of aluminum and other raw materials had firms scrambling to meet their banking covenants and left some rushing for the equivalent of Chapter 11 bankruptcy protection.

Philip Wylie

For more detailed information on recent M&A activity in the automotive industry go to www.pwc.com/cf/insights
2005 PwC Automotive Shareholder Value Awards

Overall industry commentary

The year 2005 delivered positive results for automotive investors, although a schism now divides the automotive industry, with players outside North America showing significantly better returns for shareholders than their counterparts. At the same time, North American players have had a certain level of success in China, while Asian automotive companies have been investing heavily in the US and remaining somewhat passive about China.

One of the most interesting recent developments may prove to be the introduction of the Geely 7151 CK at the Detroit Auto Show. Initially, Geely planned to launch this vehicle in the US in 2008. Since then, however, Geely has decided to delay its US debut in order to develop and assemble a car especially built for the US and European markets. The impending introduction of a Geely (or other Chinese-branded) vehicle in the US serves notice on Detroit that China could be flooding the US with low-price cars and trucks in the very near future.

While the overall automotive industry has shown strong returns over the last three years, it still faces many significant challenges:

> **OEM/Supplier financial viability** – Notable bankruptcies, restatements, legacy costs and other factors are putting the highly leveraged supply base at risk. Delphi’s recent bankruptcy filing demonstrates that financial challenges are not limited to small suppliers. These dynamics affect the entire automotive supply chain, as well as the OEMs, as the costs of bailing out troubled key suppliers are increasing.

> **Debt downgrades** – As domestic OEM and supplier debt continues to be downgraded, borrowing costs add pressure to the bottom line. This increases the competitive pressure on North American OEMs as they try to maintain a lower cost structure.

> **Possible strikes** – Despite recent threats by the UAW that a strike is imminent, both the union and the automakers realise that a strike may make the current financial environment even worse. What will unfold remains uncertain.

> **Effect of higher fuel prices** – Sustained higher fuel prices are having an impact on consumer purchasing decisions. SUV sales have fallen, while sales have increased for cross-over utility vehicles (CUVs) and hybrid vehicles.

> **US dollar weakness** – Companies with currency imbalances may face financial and commercial pressure if the trend of a depreciating US dollar continues.

The PwC Automotive Institute indicates that total North American light vehicle production was essentially unchanged in 2005, registering 15.8 million units, while global production is forecast to have risen 2.6% to 61.8 million units in 2005. The Asia-Pacific region accounted for as much as 82% of this growth (1.6 million units), and automotive companies continue to invest heavily to establish a presence in Asian countries. For 2006, the AUTOFacts forecast calls for a further 1.7 million unit increase (+2.8%) in global volumes to 63.5 million vehicles – which would make 2006 the fifth consecutive year of...
increases in light vehicle assembly. Asia-Pacific is again expected to account for the majority of this growth (56%).

This is the third consecutive year that all three automotive sectors – Global Vehicle Manufacturers, Global Parts Suppliers and US Automotive Retailers – generated positive one-year and three-year returns.

Global vehicle manufacturers

Vehicle manufacturers can largely be separated into two groups of late – the “haves” and the “have nots” – referring, of course, to market share. Asian manufacturers are on the rise in the US and elsewhere, with Toyota expected to overtake General Motors as the world’s largest automaker. For automakers on the rise, all is well, but companies losing share are experiencing great pain.

Supplier financial viability, legacy costs, union tensions and declining market share, coupled with increased fuel costs and rising interest rates, pose a “perfect storm” of operational and financial risks to some global vehicle manufacturers in the periods to come.

Global parts suppliers

Suppliers are facing the realisation that some of their largest customers may be facing bankruptcy. Rising automobile production in Asia is an opportunity for larger, multinational suppliers to increase sales and profits, while also serving as a natural hedge against domestic production cuts.

The number of global suppliers is shrinking as companies merge or, in some cases, face tremendous financial challenges. This trend is likely to continue, particularly with acquisitions of smaller firms further down the supply chain. With vehicle manufacturers pressuring suppliers to reduce costs, suppliers are using acquisitions to spread overhead costs over a greater volume. Acquisitions may also help suppliers to produce the integrated systems and modules that vehicle manufacturers are demanding.

At the same time, high raw material costs are increasing the volatility of operating margins at many suppliers.

US automotive retailers

The retail battle for sales is taking place mainly on the dealership floor, where price and service are the primary concerns of consumers.

Over the past several years, automotive retailers have been pushing to diversify their product lines. This has enabled retailers to offset slowdowns in certain market segments with increased sales in others. Retailers have recently focused on import and luxury brands, where sales continue to grow. Domestic nameplates continued to lose market share following the employee pricing programs during the summer months of 2005.

PwC Automotive Shareholder Value Indicators – A method to evaluate comparative returns

Increasing shareholder value is a paramount objective for all management, including automotive industry leaders. Knowing a company’s total shareholder return trend by itself and in comparison to global industry peers is a critical analytical measure of success. Knowing the trend of the sector’s returns compared to broad markets can provide further insights on relative performance.

The PwC Automotive Shareholder Value Total Shareholder Returns (“TSR”) indices help support this analytical need. The indices take into account the rise and fall in a company’s share price, dividends, share buy-backs and new share issues; they provide an objective and reliable measure of shareholder value for stock market listed companies. The indices and analysis behind them are published quarterly...
in Automotive News. Annual awards are presented in conjunction with Automotive News at the World Congress Gala Dinner each January to recognise the highest total shareholder return for Global Automotive Vehicle Manufacturers, Global Parts Suppliers, and US Retailers.

The following outlines key results of the sectors during 2005 and the year’s award recipients.

**Automotive Industry Performance by Segment – Periods Ended December 31, 2005**

Global Automotive Shareholder Value Indices

Source: PwC's Global Shareholder Value Indices

### Growth in Shareholder Value Indices

<table>
<thead>
<tr>
<th></th>
<th>Periods ended 12/31/2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>One year</td>
</tr>
<tr>
<td>Global Vehicle Manufacturers</td>
<td>9.4%</td>
</tr>
<tr>
<td>Global Parts Suppliers</td>
<td>13.4%</td>
</tr>
<tr>
<td>US Retailers</td>
<td>7.1%</td>
</tr>
<tr>
<td>Dow Jones Industrials</td>
<td>1.7%</td>
</tr>
<tr>
<td>S&amp;P 500 Composite</td>
<td>4.9%</td>
</tr>
<tr>
<td>FTSE 100</td>
<td>8.0%</td>
</tr>
</tbody>
</table>
The Total Shareholder Returns indices revealed the following overall results:

**Global Vehicle Manufacturers** posted one-year and three-year returns of 9.4% and 69.0%, respectively, while recording a 0.9% loss for the fourth quarter of 2005. The vehicle manufacturers outperformed both the Dow Jones Industrials and S&P 500 for the one-year and three-year periods and have performed slightly better than the FTSE 100 over the same periods.

**Global Parts Suppliers** posted fourth-quarter, one-year and three-year gains of 8.8%, 13.4% and 112.8%, respectively, which led the three SVI auto segments in addition to the Dow Jones Industrials, S&P 500 and FTSE 100 in the one-year and three-year periods.

The **US Retailers** posted returns of 3.6%, 7.1% and 76.2%, in the fourth-quarter, one-year and three-year segments, respectively. The retailers have largely outperformed both the domestic and foreign markets in the three-year period.

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2005 Automotive Shareholder Value Award recipients

Amid the strong overall performance of automotive stocks in 2005, certain companies rose to the top of each index. The 2005 Automotive Shareholder Value Award recipients were:

**Global Vehicle Manufacturers – Three-year**

**Hyundai Motor Company** led vehicle manufacturers for the three-year period with a return of 329%. Despite the relatively low cost of its automobiles, Hyundai now tops reports for quality and reliability, which has greatly assisted efforts to increase sales. Hyundai’s ability to penetrate foreign markets through imports has been aided by its ability to manufacture in low-cost countries. Hyundai is committed to establishing a greater presence in the markets to which it sells as it invests the necessary capital to increase production capacity.

**Global Vehicle Manufacturers – One-year**

**Hyundai Motor Company** outperformed other vehicle manufacturers for the one-year period with an 80% return. Among all global vehicle manufacturers, Hyundai has posted the highest returns for two consecutive quarters, demonstrating consistent positive results. This can be attributed to strong growth in sales, an effective product mix and solid operating methodologies.

**Global Parts Suppliers – Three-year**

**Continental AG** was the top performer among suppliers in the three-year period with an outstanding return of 509%. Over the last several years, Continental has transformed itself from a supplier of tires and rubber products to a systems and modules supplier. This was achieved both
through acquisitions and organic growth. With margins in excess of 17%, Continental has stated that it may make further acquisitions going forward. The company’s low debt relative to competitors and high cash flow should aid in facilitating such acquisitions.

Global Parts Suppliers – One-year

Akebono Brake Industry Co. finished first among suppliers with a one-year return of 57%. During the year, Akebono Brake bought out Delphi’s stake in their joint venture, Ambrake, making it a wholly owned subsidiary. Profits from North American operations were down due to production cuts by domestic OEMs, but this was offset through cost reductions and sales increases elsewhere. Operations continue to maintain pace as the company diversifies its customer base.

US Retailers – Three-year

United Auto Group, Inc. led US retailers with a three-year return of 216%. United Auto Group’s growth can be partially attributed to acquisitions of foreign-make dealerships in an attempt to diversify from traditional domestic nameplates. As the import and luxury markets continue to grow, the company has been able to provide higher shareholder returns than its peers.

US Retailers – One-year

United Auto Group, Inc. was also the best performer for the one-year period, with a 31% return. United Auto Group’s strategy of acquiring more foreign dealerships increased used car sales revenue as import cars tend to have higher resale values than their North American counterparts. United Auto Group has also focused on the higher margin parts and service market, which has aided the company’s profitability.

Aaron Witalec
International Financial Reporting Standards

International Financial Reporting Standards (IFRS) have become a reality for many companies around the world, particularly, but not limited to, those in the European Union. In the automotive industry, it is not yet clear whether the benefits of IFRS outweigh the burden of the transition and the challenges to come.

The answer may depend on whom you ask. In two surveys conducted in Britain by PwC and Ipsos in April and May 2006 involving FTSE 350 executives and fund managers, 58% of the executives said the new accounting rules had brought no benefits and 85% said the rules had made it more difficult to explain their results. In contrast, one-third of the fund managers reported changing investment decisions as a result of the standards.

Many automotive companies have now completed the transition and have published their first set of annual accounts under IFRS and many automotive companies are preparing to join the others under IFRS in the next few years. It is worth reflecting on some challenges they have faced and will continue to face.

A challenging market context

The automotive industry requires significant upfront investment, often with great uncertainty about expected returns. The commercial success of a vehicle depends on a car maker’s ability to match customers’ needs across the globe all while creating standardised production platforms in order to maximise margins. Other complications include skyrocketing raw material prices in an industry that is a heavy consumer of commodities, complex production arrangements between original equipment manufacturers and their suppliers, and heavy pension commitments in a labour-intensive industry.

All these ingredients make the application of IFRS a heavy burden for many companies, requiring complex judgments on how to put the standards into effect and forcing CEOs and CFOs to spend time explaining the judgments they have made.

The impact on first-time adopters

For automotive companies that issued their annual reports in compliance with IFRS for the first time, the standards generally had a major impact on their accounting for development costs, tooling, fixed assets and goodwill impairment, buyback arrangements, pension obligations and commodity hedging.

Development costs

Under most GAAP in Europe, development costs were usually expensed as they were incurred. Under IFRS, development costs that meet the criteria of IAS 38 are capitalised.

“Companies must demonstrate:

> The technical feasibility of completing the intangible asset so that it will be available for use or sale;
> The intention to complete the intangible asset and use or sell it;
> The ability to use or sell the intangible asset;
> The ability of the intangible asset to generate probable future economic benefits;
The availability of adequate technical, financial, and other resources to complete the development and to use or sell the intangible asset;

> The ability to measure reliably the expenditure attributable to the intangible asset during its development.

In practice, some of these steps have proven to be relatively easy to demonstrate, as they correspond to very specific and usually documented milestones in the development process in the industry. But demonstrating the ability of the intangible assets to generate probable future economic benefits has proven difficult. That single provision of the standard has required many companies to prepare formal cash-flow projections project by project.

Going forward, companies will face a challenge in monitoring the profitability of recognised intangibles, particularly when such intangibles are serving different platforms with different rates of return.

Tooling arrangements

It is not uncommon in the automotive industry for tooling arrangements to exceed a 12-month development period. This leads to questions of how costs and revenues should be recognised over time and when a tool is considered to be sold by a supplier to an OEM.

Additionally, these contracts are usually part of a broader production agreement, and this raises the question of whether profits or losses on the sale of a tool by a supplier to an OEM should be recognised immediately or deferred over the life of the underlying platform.

Finally, certain legal conditions surrounding the tooling arrangements make it difficult to assess whether the supplier or the OEM ultimately bears the risks and rewards associated with the tool, and thus whether the tool can be considered as sold to an OEM after its production period.

The adoption of IFRS led many automotive companies to do in-depth analyses of the legal terms and conditions of their tooling arrangements, and in some cases the contracts were amended to better reflect the underlying economics of such arrangements.

Fixed assets and goodwill impairment

Fixed assets and goodwill are uniquely exposed in the automotive industry to impairment risks, mainly because the industry is not only highly capitalised but also know-how intensive. This can lead to a significant number of assets being impaired if a car model performs poorly.

When indicators of impairment exist, IFRS has forced auto companies to develop cash-flow projections for each cash-generating unit. This consumes time and resources, and producing such projections has required many organisations to reorganise their reporting processes. Also, because such projections reflect management’s beliefs about the probable outcome of its actions, the projections have in many cases required the involvement of CEOs and CFOs.

In addition, a number of complications can arise when applying IAS 36, which defines the recoverable value of a
given asset for which indications of impairment have been identified. IAS 36 restricts the extent to which value-in-use calculations can reflect future capital expenditures and cost savings. Essentially, the future cash flows should be calculated for the asset in its current condition, and future improvements in asset performance should not be taken into account, except where they are necessary to make the asset ready for use.

These restrictions are often difficult to apply to the automotive industry, as restructuring activity is almost continuous in light of the constant need to upgrade production facilities. In practice, it is not always easy to distinguish cost savings from future operational improvements.

Such difficulties may mean that automotive companies will not regard value-in-use calculations prepared under IAS 36 as providing an appropriate basis for determining impairment provisions. Many companies may be forced to adopt the fair-value-less-costs-to-sell model, although IAS 36 contains little guidance on how this alternative model should be applied.

**Buyback arrangements**

Buyback arrangements are a common way for companies to improve sales of new vehicles. Through such arrangements, manufacturers sell new cars to fleets, rental companies or even individuals with a commitment to buy them back after a period of time, usually three years.

Under IAS 18, revenue is recognised when a series of conditions have been satisfied:

> The entity has transferred to the buyer the significant risks and rewards of ownership;

> The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the cars sold;

> The amount of revenue can be measured reliably;

> It is probable that the economic benefits associated with the transaction will flow to the entity;

> The costs incurred or to be incurred in respect of the transaction can be measured reliably.

With IAS 18, the legal transfer of ownership is no longer sufficient anymore to determine whether the seller has transferred most of the risks and rewards. In particular, the automaker may retain the risk related to the residual value of the cars bought back — that is, the risk that the fair value of the used car will be lower than the contracted buyback price. Additionally, IAS 18 provides little guidance as to how to assess the transfer of risks and rewards or to define significant residual risk.

Some OEMs have elected to present the cars sold under buyback agreements for which the OEM is deemed to retain the significant risks and rewards as fixed assets in application of IAS 16, while others have elected to present such cars as inventory. So far, the auto industry has not actively tried to resolve such differences or to coordinate an approach.

**Retirement and other long-term benefits**

In an industry that is highly labour intensive and where employee benefits are substantial, the accounting treatment of such obligations has required an extensive effort for many companies. Most major automobile companies have worldwide activities, with significant subsidiaries in low-cost countries. During the transition, local accountants or financial executives have struggled in trying to understand the agreements in place and the way that IAS 19 would apply to them. Many have turned to actuaries to determine the applicable accounting treatment.
Commodity hedging

With raw material prices skyrocketing in recent years, the need for protective mechanisms has grown sharply in an industry that is one of the biggest consumers of steel, copper and aluminium. As a result, many automotive companies have an array of long-term commodities hedging contracts. Such financial instruments, commonly known as derivatives, must be recorded on the balance sheet at fair value, with gains and losses from re-measurement recorded in the income statement, unless the complex qualifying criteria for hedge accounting of IAS 39 can be met.

This raises a number of challenges for the automotive industry. If a company qualifies for hedge accounting, the hedging instrument’s gains or losses are either matched against the losses or gains to which they relate, or they are recognised through equity until the hedged item affects the income statement. This is permitted, however, only where strict documentation standards and other requirements have been complied with.

From an operational standpoint, the complexity of these agreements and the level of documentation required to comply with hedge accounting have required many companies to considerably reinforce the processes to collect and assemble the required data and to control their quality to ensure consistency of the policies applied across the company.

Car makers are often party to complex commercial contracts that can contain embedded derivatives (for example, contracts indexed to market-based variables such as commodity prices or foreign exchange rates), thus requiring an in-depth analysis of all significant existing agreements.

The impact on financial communication

Chief Executives and Chief Financial Officers express considerable discomfort with the new standards. Knowing that a fair view of the value of their business is essential to their shareholders, they commonly rely on the income statement as a versatile tool for explaining how their strategies are producing the desired result. With the implementation of IFRS, executives now spend a significant amount of time in explaining the increased volatility resulting from short-term conditions.

Under IFRS, certain items particularly significant to the industry, such as impairment calculations and the valuation of long-term benefit obligations or stock options, are highly dependent on pure financial assumptions – particularly on discount rates. Even though they may provide investors with useful information as to the value of the business at the balance sheet date, such highly volatile measures may not be very helpful in understanding the long-term factors driving a business that is focused on long-term investments. Under such circumstances, automotive executives need to provide investors with information explaining the volatility in the income statement and providing measures that benchmark the performance relative to other automotive companies.
New challenges ahead

Although significant adjustments have been made across the industry in adopting the standards for the first time, other changes may follow. Consider the matter of accounting for joint ventures, in which companies share the heavy burden of development and start-up costs. So far, the existing standard, IAS 31, allows proportional consolidation, an imperfect way to reflect shared assets located in single companies in which the venture partners hold joint legal title over the assets and share joint control.

The International Accounting Standards Board (IASB) has been studying joint venture accounting and in December 2005, it provisionally decided to remove the option of proportional consolidation for jointly controlled entities – and therefore to allow only equity accounting. It also decided to expand its research project to consider joint ventures, because it felt the current standard did not adequately address the difference between a joint venture and an undivided interest in the assets and liabilities of a joint arrangement. In the meantime, the board has decided to suspend work on its long-term research, pending the outcome of its current projects (that is, consolidations, conceptual framework, short-term convergence) on joint-venture accounting. If the proportional consolidation option were to disappear, some companies might decide either to withdraw from those kinds of arrangements or to expand their notes to their financial statements with a more comprehensive view of their sales and margins.

In a similar vein, early in 2006 the IASB issued the draft of a proposed amendment of IAS 14, covering segment reporting. Under the revised standard, financial information would have to be reported on the basis that it is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments. Such revisions may provide more transparency, but they may also embarrass automotive suppliers if their internal documents disclose that some activities are highly profitable.

Last but not least is the need to reinforce processes and controls surrounding the production of financial information complying with International Reporting Standards. Insufficient documentation of accounting policies and procedures remains the single largest cause of material weaknesses in the automotive industry in the United States, with some slight improvement in Year 2. As IFRS standards are in many ways as complex as US GAAP – if not more complex, as they involve more judgment – European companies, having generally operated previously with weaker regulations, may face incremental documentation issues.

Philippe Vincent
Year 2 in review

It is hard to believe that we are halfway through Year 3 of section 404 of the Sarbanes-Oxley Act of 2002 (SarbOx). Year 1 was a whirlwind of work that many companies had difficulty completing by the established reporting deadline. In Year 2, companies made significant progress with open Year 1 deficiencies. This progress can be evaluated by reviewing Form 10-Ks filed with the Security and Exchange Commission.

Our review of reported material weaknesses in 2005 (Year 2) and 2004 (Year 1) found a reduction in the number of adverse SarbOx 404 opinions. Through June 27, 2006, 7.8% of 2005 Form 10-Ks (across all industries) reported an adverse 404 opinion. On a comparative company basis, 12.9% of companies reported an adverse 404 opinion in 2004. That is an impressive improvement.

Within the automotive industry, the results are at first glance a bit disappointing. In 2005, 14% of automotive companies reported an adverse 404 opinion, up from 13% in the preceding year – and only one other industry showed an increase in Year 2 in the percentage of adverse opinions, while 13 industries showed a decrease. (Note: the 2005 data may change as late filers submit their reports to the SEC.)

Yet a closer look finds that the automotive industry has, in fact, improved its performance. The number of automotive companies reporting adverse 404 opinions declined 20%, to 8 in 2005 (through June 27, 2006), from 10 companies in 2004, and the number of reported material weaknesses for these automotive companies has been reduced to 16 from 36 in the previous year. Only on a comparative company basis do the numbers show an increase.

With regard to material weaknesses reported by automotive companies in 2005 and 2004, the table below shows that the concentration of financial statement accounts affected by material weaknesses generally remained unchanged from Year 1 to Year 2.

<table>
<thead>
<tr>
<th>Financial statement area impacted by control weakness</th>
<th>Year 2</th>
<th>Year 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory, vendor and cost of sales issues</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Liabilities, payables, reserves and accrual estimate failures</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>PPE / Fixed Asset / Intangible asset (FAS 142 - valuation / diminution)</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Tax expense / benefit / deferral / other (FAS 109) issues</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Revenue recognition issues</td>
<td>1</td>
<td>4</td>
</tr>
</tbody>
</table>
By their very nature, the operations of an automotive company (both original equipment manufacturers and suppliers) involve such areas as inventory, accrued liabilities, fixed assets and income taxes, where control issues are more likely to arise. Although progress was made in Year 2, these areas remain problematic. In contrast, significant progress has been made with respect to controls over revenue recognition. The importance of revenue recognition has received much attention from both analysts and the SEC, and it is good to see the number of issues in this area decline so dramatically.

The specific control failures giving rise to material weaknesses at automotive companies also showed improvement in Year 2. A comparison of the nature of material weaknesses reported by automotive companies is shown in the table below.

<table>
<thead>
<tr>
<th>Nature of internal control weakness</th>
<th>Year 2</th>
<th>Year 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting documentation, policy and / or procedures</td>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td>Material or numerous auditor / year-end adjustments</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Accounting personnel resources, competency / training</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Restatement or non-reliability of company filings</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Information technology, software, security and access issue</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Segregations of duties</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Untimely or inadequate account reconciliation</td>
<td>0</td>
<td>3</td>
</tr>
</tbody>
</table>

Insufficient documentation of accounting policies and procedures remains the single largest cause of material weaknesses, with some slight improvement in Year 2. Material adjustments and year-end audit adjustments also contribute significantly to material weaknesses. However, automotive companies should be applauded for their progress in other areas that were problematic in Year 1. Efforts to improve staffing and training of accounting personnel, for example, reduced the number of reported issues in this area by 50%. Additionally, companies appear to understand the importance of account reconciliations and have made tremendous progress in this area.

**Looking forward – year 3**

The focus of automotive companies in Year 2 was largely “right-sizing” the number of key controls. Based on the experience gained in Year 2, companies realised in Year 2 that too many controls had been identified as key. Many of these controls were operationally oriented rather than financially oriented, duplicative of other financial reporting controls in lower risk areas or, upon closer examination, not truly “key” to preventing a material misstatement of the financial statements. The optimisation of these controls served to improve both the efficiency and effectiveness of assessing internal controls over financial reporting.

Management teams are not standing still in Year 3. Companies continue to refine their processes through further control optimisation. Additionally, companies are looking for ways to better leverage controls around shared service centres and common information technology platforms. Lastly, companies are re-examining how they will test these controls in Year 3. Opportunities exist for management to adopt a risk-based approach to vary the nature, timing and extent of their testing in the assessment of internal control over financial reporting and to use control self-assessments to a greater extent. However, as
management teams decide on such choices, they should work closely with their external auditors, as these changes may impact the extent to which the external auditors can rely on their work.

Regulatory outlook

On July 11, 2006, the SEC issued a Concept Release Concerning Management’s Reports on Internal Control over Financial Reporting, seeking comments on the nature and extent of additional guidance that it should develop to assist management in carrying out evaluation and assessment of internal control over financial reporting under Section 404 of SarbOx. The issuance of the Concept Release represents the first step in the development of that guidance.

SEC Chairman Christopher Cox said the SEC’s goal is to develop guidance for companies to help improve the reliability of financial reporting and to make the implementation of Section 404 more efficient and cost effective.

The SEC intends that the forthcoming guidance for management be scalable, so that it would assist companies of all sizes. The guidance would address at least the following areas:

Risk and control identification

How to identify risks to reliable financial reporting, including risks of fraud.

> How to identify controls (including company-level, financial statement account, and disclosure-level controls) that address the recognised risks that a company faces.

> How to address common implementation difficulties (e.g., materiality considerations, multi-location issues and the concept of “key” controls).

Management’s evaluation

Factors management should consider in determining the nature, timing and extent of its evaluation procedures, including the consideration of company-level and information technology general controls.

> Considerations in determining the severity of an identified control deficiency.

Documentation to support the assessment

Appropriate levels of documentation to support management’s assertion, including how to address controls that do not result in documented evidence.

Rather than waiting on the sidelines for the SEC’s guidance, company management is moving forward with individual improvement plans.

Final thoughts

Following the turmoil of Year 1 and the control optimisation efforts of Year 2, Year 3 of SarbOx will hopefully be one of “relative” stability. Of course, this is contingent on the SEC’s forthcoming guidance for management and upon the particular circumstances of individual companies (i.e., acquisitions, divestitures or information system implementations will impact each company’s SarbOx efforts). Notwithstanding these changes, refinements will undoubtedly continue in Year 3, but at a more manageable pace.

Ken Coy
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 to 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.

The financial data utilised to prepare the graphs are included in Appendix B. The companies omitted from the accompanying graphs did not disclose sufficient data.
Vehicle manufacturer net income margin

Vehicle manufacturer return on net assets ranged from -5.5% to 11.8% and averaged 3.04%.

Vehicle manufacturer gross profit margin

Vehicle manufacturer gross profit margins ranged from 9.10% to 55.13% and averaged 22.63%.
Vehicle manufacturer capital expenditures as a percent of total revenue

Vehicle manufacturer capital expenditures as a percent of total revenue ranged from 2.59% to 5.21% and averaged 7.13%.

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 .46% to 5.28% and averaged 3.68%.
Vehicle manufacturer revenue per vehicle

Vehicle manufacturer revenue per vehicle ranged from $2.4 to $94.78 and averaged $26.78.

Vehicle manufacturer return on assets

Vehicle manufacturer return on assets ranged from -6.36% to 8.45% and averaged 2.58%.
Vehicle manufacturer return on net assets

Vehicle manufacturer return on net assets ranged from -72.39% to 24% and averaged 5.35%.

Working manufacturer capital ratio

Working capital ratios ranged from 0.72 to 4.57 and averaged 1.33.

1. DaimlerChrysler AG
2. FIAT S.p.A
3. Ford Motor Co.
4. General Motors
5. Honda Motor Co., Ltd.
6. Mitsubishi Motors Corp.
7. Peugeot Citroën SA
8. Toyota Motor Corp.
9. Volkswagen AG
10. Renault SA
11. Nissan Motor Co., Ltd.
12. Mazda Motor Corp.
13. BMW Group
15. Porsche AG
16. Hyundai Motor Corp.
17. Subaru - Fuji Heavy Industries
Vehicle manufacturer leverage ratio

Vehicle manufacturer leverage ratios ranged from 0.06 to 27.77 and averaged 4.78.

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<th>Rank</th>
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<td>1</td>
<td>DaimlerChrysler AG</td>
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<td>Peugeot Citroën SA</td>
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<td>Toyota Motor Corp.</td>
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<td>Volkswagen AG</td>
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<td>Hyundai Motor Corp.</td>
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<td>17</td>
<td>Subaru - Fuji Heavy Industries</td>
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Average leverage ratio: 4.78
Independent supplier net income margin

Independent supplier net income margins ranged from -18.5% to 7.2% and averaged 0.85%.
Independent supplier gross profit margin

Independent supplier gross profit margins ranged from 2.43% to 34.91% and averaged 14.64%.

1: Gross profit margin for Robert Bosch GmbH does not incorporate direct production labor costs.
Independent supplier capital expenditures as a percent of revenue

Independent supplier capital expenditures as a percent of total revenue ranged from 1.64% to 12.24% and averaged 5.35%.
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 0.29% to 8.10% and averaged 3.88%.
Independent supplier revenue per employee

Independent supplier revenue per employee ranged from $146.29 to $417.26 and averaged $226.93.
Independent supplier return on assets

Independent supplier return on assets ranged from -21.72% to 9.47% and averaged 0.46%.
Independent supplier return on net assets

Independent supplier return on net assets ranged from -294.50% to 562.50% and averaged 30.44%.
Independent supplier working capital ratios

Independent supplier working capital ratios ranged from 70.02% to 187.91% and averaged 130%.
Independent supplier leverage ratio

Independent supplier leverage ratios ranged from -3.68 to 4.10 and averaged 0.73.
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 quotations presented below focus on 10 recurring themes from the 2005 annual reports:

- Overall industry and economic context for 2005
- Strategies for success
- Technology and innovation
- Collaboration and partnering
- Cost reduction
- People
- Ethics and corporate governance
- Environmental consideration
- Opportunities in China, Asia-Pacific and Eastern Europe
- Predictions

Overall industry and economic context for 2005

Most chairmen place the emphasis on the economic environment, which remains difficult, and which is still characterised by increasing prices for raw materials, fuel and energy and strong pressure on sales prices. Other key issues discussed include an increase in geo-political challenges and the intensification of competition within the industry.

General Motors

“It was the year in which GM’s two fundamental weaknesses in the US market were fully exposed: our huge legacy cost burden, and our inability to adjust structural costs in line with falling revenue.

The challenges we cited in this space a year ago – global overcapacity, falling prices, rising health-care costs, higher fuel prices, global competition – intensified and significantly weakened our business.

Fuel prices increased sharply through the year, reducing demand for some of our highest-profit trucks, and tilting our sales mix more toward lower-margin cars. The devastation of Hurricane Katrina also had an impact, both on fuel prices nationally and on vehicle sales.”

Autoliv Inc.

“2005 was a challenging year for the automotive industry. Steel prices skyrocketed and vehicle production declined in Western Europe, our most important market. Several vehicle manufacturers were faced with heavy losses, and some suppliers (as well as Rover) even had to file for bankruptcy. […]

In 2004, the US government proposed new regulations that could, in effect, mandate such curtain airbags on all new vehicles by 2011. As a result, we expect sales for this product to continue to grow during the rest of this decade.”

GKN plc

“In a year of mixed automotive markets and escalating raw material and energy costs our Automotive businesses in total increased sales and produced a very respectable level of profits. Programme wins and successful new
product launches confirmed Driveline’s market and technology leadership and a soundly based improvement in Sinter Metals’ performance underpinned our continued confidence in this sector. Off Highway increased both sales and market share and the proportion of its revenues derived from the global construction equipment market. The successful transformation of Aerospace is confirmed by our results and we further strengthened our position on the world’s latest aircraft and engine programmes.”

**Magna International Inc.**

“Despite significant difficulties in the North American and European automotive markets, Magna had another year of solid operating result.

However, Magna’s future success is tied to a great extent to the success of our major customers in this competitive global automotive industry. Unfortunately, some of our major automotive customers have been experiencing declining production volumes and reduced profitability and competitiveness. This troubling decline in competitiveness in the North American and European auto markets has been evident for the past few years.”

**Michelin Group**

“Despite an economic environment marked by the continued rise in raw material costs and the significant decline in the European Truck tire market, we have achieved our operating margin target before non-recurring items, which was up slightly from 8.7% in 2004 to 8.8% in 2005. […] Raw material costs rose by more than 60% in the course of the last 4 years at constant currency, with a hike of 15% in 2005 alone. Michelin was able to restrict the impact on its gross profit margin through its firm pricing policy and continued growth in the higher value-added, technically advanced segments, reflected in significant sales growth for both the Michelin and BFGoodrich brands.

Coupled with efficient control of structural costs, this strategy translated into a 5% increase in operating income before non-recurring items to EUR 1,368 million.

This performance was delivered in spite of a decrease in sales volumes mainly due to the decline in the European Truck tire market and to a drop in the number of lower value-added tire sales in North America.”

**Faurecia**

“The structure of the automotive industry as a whole continued to evolve in 2005 with the market becoming more and more segmented; this has led to an increasing number of vehicle models, the pursuit of growth in all geographical areas and globalization of cost structures.”

**Strategies for success**

To safeguard profitability and to reinforce the competitive position in a sluggish economic context, nearly all chairmen present action plans including measures such as restructuring the product portfolio and value chains, development of new products, modernisation of production processes and penetration of growth markets in Asia and other parts of the world.

**Fiat SpA**

“We had committed to a drastic cut in net industrial debt – and it was reduced by two-thirds.

We had decided to focus on the re-launch of our Automobile activities, and in the last quarter of 2005 Fiat Auto posted a trading profit of 21 million euros after 17 consecutive quarters of losses.

This has contributed to restoring Fiat’s credibility, not only in Italy, but internationally, as evidenced by the improvement in our debt ratings and our ability to attract a large number of institutional investors in our debt raising activities.
Our reputation has also benefited from the launch of new models across all brands that have been received extremely well by the public for their creativity, style, technology, and innovation, qualities that have distinguished the best Fiat cars since the firm was founded.

Fiat’s business governance structure, especially in Automobiles, was right-sized to match realistic demand and market conditions. In Autos we have put in place a fully market-oriented organization, unbundling the brands: Fiat, Lancia and Alfa Romeo now face the customer on their own, while sharing key functions such as manufacturing, quality and safety.

Everything is driven by the brands and for the brands. Similarly, in Agricultural and Construction Equipment, Case New Holland was reorganized along four brands rather than regions.

And we have begun to aggressively streamline processes throughout the organization.

We will remain focused on reducing costs in non-essential areas, while continuing to invest in innovation. We will complement our advanced technological resources with better commercial organization and more efficient services.

Finally, we will continue to seek new international opportunities, implementing our strategy of targeted alliances with key partners who will help us reduce capital commitments, and share investments and risks.”

**Ford Motor Company**

“We concentrated on improving our core automotive business. We divested several non-core companies, lowered our costs, refocused our financial operations on supporting our automotive business and launched the biggest wave of new products in our history.

So, in January 2006, we launched the most fundamental restructuring in our history, which we call the “Way Forward” plan. Way Forward is a comprehensive plan for restructuring and reinvigorating our automotive business in North America. It touches every piece of our North American business to make it more customer-focused, product-driven and efficient.

Along with our substantial cost restructuring, we are changing the business model that’s existed for many decades at Ford.”

**General Motors**

“Essentially, we are changing our business model to deal with the larger phenomenon of globalization and the competition it has brought to the US economy.

GM Europe cut its losses significantly based on good consumer acceptance of our new vehicles and strong progress on our cost restructuring initiatives.

In 2005, we laid-out and began to aggressively implement a four-point turnaround plan aimed at strengthening our competitive position and achieving strong business results for years to come. The four elements of our plan are:

> Keep raising the bar in the execution of great cars and trucks.
> Revitalize our sales and marketing strategy.
> Significantly improve our cost competitiveness.
> Address our health-care and pension legacy cost burden.

We’re also continuing to make significant progress in quality.

Another key element of our plan to grow revenue is revitalizing our sales and marketing strategy. We’re putting great emphasis on building and differentiating each of our automotive brands around the world, and accelerating our drive for consistent, world-class distribution networks.

The lower prices have given consumers a compelling reason to try our new vehicles, and it’s working.”
Renault SA

“[…] Twenty-six new models will be launched during the plan.

Renault Commitment 2009 means mobilizing all our forces in the service of three commitments – quality, profitability and growth.

> Quality is both our first duty to our customers and the first commitment of the plan. The future Laguna will embody this commitment by ranking among the top three cars in its segment for product and service quality. The progress achieved will be applied with the same diligence across the entire range.

> Profitability is the second commitment. We will raise our operating profit margin to 6% of revenues through unwavering efforts to contain costs and expand our product offering. Renault’s short-medium- and long-term management will be focused on customers and driven by profit.

> Our third commitment is to sell an additional 800,000 units in 2009 as compared to 2005.

> Our ambitious growth objective will be achieved by reinforcing the product range and making significant progress in quality and technology. This drive will be supported by technological advances achieved through the synergies generated with Nissan in the Alliance. We are preparing a full range of alternative technologies to reduce fuel consumption and CO2 emissions. We will also continue to innovate in passive safety to consolidate our European leadership in this field. Sustainable development is central to our strategy as well, reflecting our concern for the protection of people and the environment, a core value of the company.”

Valeo SA

“Targeted acquisitions and technological partnerships are integral parts of our development strategy, which aims to make Valeo one of the world’s top five automotive suppliers by 2010. Our recent acquisition of Johnson Controls’ Engine Electronics Division and 100% of the shares of the Zexel climate control and compressor activities in Asia have significantly boosted our Powertrain Efficiency and Comfort Enhancement Domains respectively, as well as our structural growth potential, particularly in China and the rest of Asia.

They have also brought some exciting new technologies to the Group, such as the fuel-saving cam less engine technology.”

Peugeot Citroën SA

“The first pathway to improvement is to meet stringent quality standards. […] The second priority is to improve our competitiveness by substantially reducing our production costs, by around €600 million a year. […] The third pathway is our innovation strategy, an invaluable source of competitive advantage. […] Lastly, the model renewal process is well under way, providing the primary driver of our future growth. […] The difference in Peugeot and Citroen’s growth during the year illustrates the benefits of having two broad line marques that complement each other, whose coexistence within the Group enables us to optimize model lifecycle management.

The platform strategy, a core component of our strategic vision, also made further progress in 2005. Following the introduction of the Peugeot 407 Coupé and the Citroen C6, the Rennes plant now produces six different body styles on the same platform. Today, the number of cars built on our three basic platforms is ramping up very quickly as a percentage of total output, attesting to the strategy’s success.”
Visteon Corporation

“We have a three-year strategy to make Visteon a viable, top-tier automotive supplier and the means to execute that strategy. Our three-year plan reflects a commitment to building a sustainable business model that will elevate Visteon to the profitable and high-performing industry leader we know it can be.

We have already initiated or achieved a number of objectives critical to our long-term success. Many of these actions are explained in detail on the following pages, including: restructuring our manufacturing operations, reducing our cost structure, continuing to expand our global footprint and diversify our customer base, strengthening our leadership team, improving our cash flow, and changing the fundamental way we do business by moving from a regional approach to one focused on our three global product groups.

Moving to a more financially sound structure allows us to unshackle many of our core businesses from the constraints of a non-competitive cost model.

We realigned our business model, moving from a regional approach to one focused on our global product groups.”

Michelin Group

“Michelin was able to restrict the impact on its gross profit margin through its firm pricing policy and continued growth in the higher value-added, technically advanced segments, reflected in significant sales growth for both the Michelin and BFGoodrich brands.

Coupled with efficient control of structural costs, this strategy translated into a 5% increase in operating income before non-recurring items to EUR 1,368 million. […]

[…] The turnaround which began some years ago in Specialty tire operations - Earthmover, Agricultural, Two-Wheel and Aircraft tires - continued in 2005.”

TRW Automotive Holdings Corporation

“Our performance can be attributed to the success of our safety product positioning in the marketplace, together with our industry-leading diversification and the benefits derived from well-executed productivity improvements and cost reduction programs, including Six Sigma, Value Engineering and Operational Excellence.

Our leading diversification improved in 2005.”

Denso Corporation

“Our strong growth over the past few years is attributable to two important qualities. One is our ability to develop the technology needed by the automotive industry, based on decades of experience and effort. The other is our ability to apply that technology to the creation of high-quality products that anticipate market needs. We do not simply supply parts in response to orders from automakers. Instead, we approach development of technology and products by monitoring the needs of our customers and the automotive society, and determine on that basis the needed technologies, and the most attractive products. The proposal of new technologies is part of our role under the long-term partnerships that we build with our customers.

This development philosophy is an outgrowth of the DENSO Vision for the medium- to long-term future that guides the day-to-day activities of every DENSO employee. New product development, in particular, is influenced by the future direction encapsulated in the Vision. With the close of the previous Vision in March 2006, we formulated DENSO.”

Continental AG

“[…] Our activities as a sponsor are already paying off: our international visibility increased measurably in the past year due to the qualifying games for the World Cup and the FIFA Confederations Cup held in Germany in 2005.”
This experience convinced us to become a sponsor of the European Football Championships in 2008.

What are the foundations for our success?

A consistently implemented corporate strategy with the following key goals:

> Our activities focus on innovations for greater safety, comfort, and eco-friendly mobility on the road.
> Depending on our customers’ needs, we act as a systems provider, module manufacturer, component supplier, and development partner.
> A cost-conscientious approach – right down to the smallest unit.
> In the long term, we will only continue to operate business units that have leading positions in their relevant markets.
> To limit the dependence on the cyclical automotive manufacturing sector, we aim to generate around 40% of our sales outside this industry.

Successful products

We hold several leadership positions, and for years we have been the undisputed market leader in Europe for winter tires. In 2005, we achieved record sales volumes of 17.7 million units worldwide, up 11% over the prior year. We were also able to increase our sales in the continuously expanding Electronic Stability Control (ESC) market to about 6 million units, a gain of 42%.

Bridgestone Inc.

“We focused on introducing innovative and appealing products, building global production capacity, raising productivity and enhancing logistical efficiency. […]

[…] We worked to maximize their sales momentum by introducing appealing new products worldwide, increasing marketing efforts and improving product mix. Strong demand in overseas markets also contributed to the sales growth.

To attain this goal, we must add higher value across all aspects of our operations. I plan to propose and lead internal reform processes so that we can clear this challenging hurdle.

We need to return to first principles by concentrating on providing the customer with quality, which is just one critical aspect. […]

[…] At the level of individual employees, we need to change up to a higher-value corporate mindset. We must also introduce reforms at the organizational level to ensure that all our management systems and processes deliver greater value in an increasingly globalized commercial environment. […]

[…] First, we must focus intently on what we need to do as a manufacturer. Fundamentally, our job is to create products and services that generate customer satisfaction. This process involves understanding customer requirements - needs as well as desires - and then designing, developing, manufacturing and selling products as well as creating services to satisfy our customers. When we do these things well we create value in the form of customer satisfaction.

We also need to look afresh at our organizational structures to enhance the value that we add for customers. […]

[…] My plan is to insert more horizontal links within the global Bridgestone organization so that we can boost customer-oriented cooperation between divisions and thereby enhance the value we add as a company.

Business domain expansion based on defined long-term strategy Vertical integration is one of Bridgestone’s greatest operational strengths.

Our challenge going forward is to leverage our depth of expertise to expand into peripheral areas with new business models that incorporate systems and solutions. […]
[...] I believe that the new system will enable us to implement global policies and strategy more quickly at the key levels of both customers and markets.

Optimized group-level management based on our Mid-term Management Plan Another change that I want to introduce involves boosting the importance of business strategy in our medium-term planning. Strategy formulation needs to incorporate the strategic vision of each division, and the plan needs to be reviewed on an annual basis. I believe that we can optimize management at the Bridgestone Group level better this way."

Technology and innovation

Innovation is considered to be a key success factor. Special focus has been placed on production processes, environmental issues and product development.

Ford Motor Company

“We are unleashing our spirit of American innovation. To me, innovation is seeing what others can’t see, and using that vision to build what others have never built. Innovation resolves contradictions and flattens old barriers. It’s the heart of all progress.

We have a proud history of innovation at Ford. It is what built our company and made it great. Innovation helped us create the first affordable car and put the world on wheels. We are going to reclaim this legacy to build a distinct competitive advantage.

We will use innovation to drive the bold American designs of our cars and trucks, giving them the uniquely American look and feel that reflect our country’s spirit, ingenuity and sense of adventure.

We also will use innovation to drive breakthrough advances in safety.

Finally, American innovation will drive our new advances in fuel-efficiency, to offset high gas prices and reduce our impact on the environment and dependence on foreign oil.”

Peugeot Citroën SA

“The third pathway is our innovation strategy, an invaluable source of competitive advantage.

It is guided by our commitment to developing useful technologies that improve safety and environmental performance, and can be deployed for the largest number of customers.

That’s why, after introducing cars equipped with Stop & Start, a first-stage hybrid system, we are now preparing a development program aimed at bringing a line-up of hybrid diesels to market by 2010. The first two demonstrators of that technology – the Peugeot 307 and Citroen C4 Hybrid HDi – illustrate our vision of the car of the future and our dedication to developing clean, fuel-efficient power-trains. Our innovation strategy is also designed to provide customers with the very best safety technology that protects all road users. Eight of our new models, for example, have earned five-star ratings in EuroNCAP tests.”

Honda Motor Company

“To succeed amid fierce global competition, Honda will further strengthen its ability to create advanced technologies and products. Our goal is to deliver new levels of value and bring products to market quickly to meet customer needs in various regions worldwide.”

Arvin Meritor Inc.

“We increased spending in research, development and engineering by 12 percent this year and are focused on developing advanced solutions in the areas of safety, mobility and the environment. These solutions include active intelligent systems to address emissions and safety
regulations worldwide, and improve the performance and reliability of our customer’s vehicles.

We are emerging as a major player in the global emissions arena. An exciting outcome of the Arvin Meritor merger is our success in applying light vehicle design and manufacturing expertise to emissions solutions for our commercial vehicle customers. In the United States, new diesel emissions standards are scheduled to take place in 2007 and 2010 that demand a 90- to 95-percent reduction in particulate matter and nitrogen oxides (NOx). Similar standards are taking place in Europe this year and in 2008. We are currently a leader in the European diesel after-treatment market, and we intend to lead the global industry in offering a complete portfolio of clean air solutions for both light and commercial vehicles.

Additional technologies in our portfolio include on-demand power steering systems, highly-integrated plastic door modules, large-opening roof systems and cross-car cradle suspension modules for passenger cars and light-duty trucks. For trucks and trailers, we introduced the first phases of the new DuraSlide™ trailer air suspension, composite springs, and an electric drive train program.

Continental AG

“[...] We are now also working with our cooperation partner ZF Friedrichshafen to develop full hybrid drives. Volkswagen AG has agreed a strategic partnership with us to develop and supply power electronics for future hybrid projects. At the same time, Continental together with ZF Friedrichshafen was commissioned to produce a hybrid drive module for a VW series model, and received another three development orders from various European automakers. We expect this market to grow strongly in the future, as hybrid drives are establishing themselves as a complement to conventional combustion engines. In the long term, they will serve to bridge the gap to electric drives in combination with future energy sources such as fuel cells. Hybrid vehicles are currently gaining significance in Japan and the U.S.A. in particular, and a similar trend is anticipated in Europe. In the tire divisions, we are continuously improving the performance of our products: for example, our development work focuses among other things on shortening braking distances, achieving optimum traction on dry and wet road surfaces, as well as cost-effectiveness – which means reducing rolling resistance and increasing tire life. Conti-Tech meets the growing requirements of the market with sophisticated solutions; these include products both for the automotive industry, such as environmentally-friendly hoses and hose lines, or for other branches of industry, such as air suspension systems for greater comfort in high-speed trains.

To continue strengthening our capabilities for the future, we increased expenditure on research and development by a total of €65.6 million in 2005 to €589.4 million.”

Michelin Group

“Innovation and quality form the very core of our strategy. The reason for Michelin’s growth in the more technical and more lucrative market segments is our ability to offer our customers high-quality and innovative products and services.

On the Truck tire segment, Michelin X One, the extra-wide tire designed to replace twin mounts, has met with overwhelming success in the United States. The year 2005 was also marked by the launch of “Michelin Durable Technologies”, a cluster of innovations which have made revolutionary breakthroughs in tire performance and tire service life for Trucks and Buses.

In the highly demanding Passenger car winter tire market, the new Michelin X-Ice North enabled us to post market share gain in Nordic countries.
In Asia, where the Group is leader on the Chinese Passenger car Replacement market, the Michelin brand went from strength to strength.”

**GKN plc**

“Three years ago we stated that GKN was determined to become a technology led company. Our progress in achieving this ambition has been rapid.

In Driveline our engineers launched two new constant velocity joint technologies which are exciting the interest of vehicle manufacturers. These new technologies represent the first breakthrough in constant velocity joint design since the product was invented 70 years ago.

In 2005 we commissioned our Advanced Composite Facility on the Isle of Wight in the UK to accelerate the development of new material and process technologies for aerospace. We are grateful for funding support from the UK Department of Trade & Industry and the South East Development Agency. The Facility was opened by Alun Michael MP, Minister of State for Industry.

GKN’s technology status in aerospace was confirmed by our selection by Northrop Grumman to join the team responsible for development and production of the X-47B unmanned combat aircraft. Prototype production work on this programme began in 2005. We also embarked on a major extension of our facility in Alabama, USA, to produce the world’s first all-composite fan case for the new General Electric GEnx jet engine for airliners such as the Boeing 787 and 747-8 and the Airbus A350.”

**Valeo SA**

“Valeo has built its technological offering around three Domains – Driving Assistance, Powertrain Efficiency and Comfort Enhancement – that correspond to market and consumer demands for enhanced safety, fuel efficiency and comfort. We have launched a number of world premiere innovations in these areas, many of which have won awards in the past year. The Start-Stop micro-hybrid system, for example, won the French “Engineers of the Year” award in the sustainable development category in 2005 and has just received the prestigious 2006 PACE Award. Our customer Citroën has also won an environmental award for this system, as well as an innovation award for its AFIL lane departure warning system developed with Valeo. The Group won its first PACE Award in 2005 for the LaneVue™ lane departure warning system.

This is a great accomplishment, particularly since this system was launched in the important North American market.

The Group continues to invest over 6% of its sales in R&D and over 500 new patents are filed every year: last year, the figure was 650. This is all part of our continuous drive to differentiate ourselves from the competition through our technology, which is a key driver of growth. The main priority today is to reduce time to market and ensure that all new product launches are flawless.”

**Collaboration and partnering**

Collaboration and partnering remains an important strategic focus. Partnering generally aims at ensuring a high level efficiency for the development of new technologies or at facilitating access to new markets, Asia in particular.

**Porsche AG**

“Another question was whether the Stuttgart-based company was abandoning the concept of its own independence as a result of this link with the corporation in Wolfsburg.

Skeptics can rest assured that nothing was further from the company’s intentions and that in fact the opposite situation applies: this investment will secure Porsche’s independence for several decades to come. We shall only be able
to make our own plans if our earnings continue to allow us to finance our growth from our own efforts.

For us, Volkswagen is a significant technological and production partner for more than a third of our sales volume. Both companies have been cooperating intensively for some time now, with great success, as the Cayenne/Touareg project confirms. The industrial logic of our Volkswagen participation is therefore also to be sought in the fact that Porsche will cooperate with Volkswagen in important technological areas, which will result in significant economies for both parties.

The anticipated annulment of the so-called ‘VW Law’, however, could easily lead to Volkswagen falling victim to a hostile take-over by investors, which could pose a threat to the continuation of our cooperation in the long term. We did not wish to face such a situation unprepared; by way of our participation in VW we have eliminated the risk of it occurring and have helped to ensure that Volkswagen – in our own interests too – will continue to flourish.

Above all, media comment has shown that the potential opportunities represented by this cooperation have in some cases not yet been identified. This makes it all the more important to emphasize that Porsche – as indeed Volkswagen as well – can derive lasting benefit from joint projects in the research, development, procurement and production areas. Cooperation in this way will generate significant economies of scale that will have a positive effect on our earnings situation.”

**Peugeot Citroën SA**

“The cooperation strategy was also actively pursued in 2005, which saw the introduction of the Peugeot 07 and Citroën C1 as part of our cooperation with Toyota, and the signature of two new agreements – one with Fiat and Tofas to jointly develop and produce small entry-level commercial vehicles and the other with Mitsubishi to manufacture new Peugeot and Citroën SUVs. We also presented the manufacturing details of our cooperation with BMW to produce small, high-tech gasoline engines and unveiled the new diesel engine line-ups developed with Ford. These cooperative agreements are having an increasingly favourable impact, and ramp-up is proceeding as scheduled. By 2008, we expect to be producing more than 500,000 vehicles and around 2,700,000 engines in cooperation with other manufacturers.”

**Fiat SpA**

“Last year, we made other important decisions that will shape the Group’s future, in the form of targeted industrial alliances with major international partners. Seven such agreements were struck in the Automobile Sector – with Pars Industrial Development Foundation (PDIF), PSA-Tofas, Zastava, Suzuki, Ford, Severstal Auto and Tata Motors – while another partnership was established in commercial vehicles and industrial engines, between Iveco and SAIC.”

**Arvin Meritor Inc.**

“Joint ventures continue to be a vital element of our global expansion and technology strategy. Our continuing operations are currently involved in 26 joint ventures, with interests in 13 countries. Our equity earnings from joint ventures were $28 million, an increase of 47 percent over the prior year. Arvin Sango, a US joint venture that produces light vehicle exhaust systems, received Toyota’s Breakthrough Supplier Quality Recognition this year. And, in March 2005, Meritor WABCO Vehicle Control Systems, our joint venture that produces antilock braking systems, announced a new electronic stability control system for commercial truck, tractor and bus applications. This major development extends our family of vehicle stability
enhancement systems and represents another milestone in our commitment to improve highway safety.

New joint ventures formed this year include:

> Two 51-percent owned joint ventures with AB Volvo in Europe to produce commercial vehicle drive axles in France and supply them to AB Volvo, under the terms of a new supply agreement.
> Sixty-percent owned joint venture with First Auto Works Sihuan Axle Brake Group in Changchun, China, to manufacture 90,000 brakes annually for both the domestic commercial vehicle market and for export.
> Fifty-percent owned joint venture with DongWon Precision Industrial Co. Ltd. to supply diesel particulate filters and related exhaust system components to automotive manufacturers in Korea.”

**Denso Corporation**

“Another example of rationalization lies in our efforts to strengthen our supply systems in the ASEAN (Association of Southeast Asian Nations) region in step with Toyota’s IMV project, which began in August 2004. We expanded the capacity of our production facilities and centralized production of each product with a single production company to reduce costs and maintain high quality—creating a supply network that can serve IMV vehicle production throughout the world. The main focus of our activities for the IMV project is Thailand, where we have established parts processing center, export center and skill training center. By centralizing and strengthening our functions in the ASEAN region, we aim to establish manufacturing capabilities comparable to those in Japan, and to create a model for our development of plants in other parts of the world.”

**Valeo SA**

“The creation of a new joint venture with Korean radiator manufacturer Threestar and a twelfth joint venture in China for ultrasonic park assist systems have further reinforced our technological and industrial footprint in Asia.”

**Eaton Corporation**

“While our focus on developing new products and services has been intensified, we have also maintained a vigorous focus upon value-creating acquisitions and new joint ventures. 2005 was a bumper year in this respect:

> In our Electrical business, we acquired Pringle Electric and launched a new joint venture in China.
> In our Fluid Power business, we completed the acquisitions of the Cobham and the PerkinElmer aerospace businesses.
> In addition, we acquired Winner, the leading supplier of hose and hose adapters in China, and we entered the filtration market with our acquisition of the filtration division of Hayward Industries.
> Our acquisition of the Pigozzi agricultural transmission business in Brazil strengthened our Truck business.
> In our automotive business, the acquisition of Tractech Holdings broadened our customer base and added important new technology to our Traction Control business. And the acquisition of Morestana in Mexico strengthened our engine air management business.”

**Cost reduction**

Cost reduction is considered to be a key challenge in the automotive industry. Chairmen highlight the principle aspects of their company’s cost reduction programmes.

**General Motors**

> “[…] We announced plans to cease production at 12 US plants by 2008, and reduce our manufacturing workforce by 30,000 positions.”
By working together with the leadership of the United Auto Workers, we reached an historic agreement that is expected to reduce our retiree health-care obligations by about $15 billion.

GM and the UAW, along with our former parts-making subsidiary, Delphi Corp., reached an agreement to reduce significantly the number of hourly employees in the United States through an accelerated attrition program.

We announced that GM will cap the company’s contribution to salaried retiree health-care costs at the end of this year, reducing that obligation by almost $5 billion.

We announced plans to significantly modify pension benefits for our salaried and executive employees, to further reduce GM’s financial risk and cost.

We voluntarily reduced salaries of our top executives – including 50 percent for me. Our Board of Directors also reduced their compensation by 50 percent.

We reduced our dividend by 50 percent.

Combined with our target to reduce net material costs by $1 billion, these actions are expected to result in annual cost reductions totalling $7 billion on a running rate basis by the end of this year, with $4 billion of that reduction to be realized during this calendar year. That’s a huge move – and it’s needed.

It is important to note here that these cost reductions will not affect our aggressive product development plans.”

**Peugeot Citroën SA**

“The second priority is to improve our competitiveness by substantially reducing our production costs, by around €600 million a year. We expect to maintain this pace of annual cost savings in the future, thanks to the full impact of our platform and cooperation strategies, the ramp-up of the internal improvement plans designed to create a unified production system and the wider application of new purchasing policies.”

**DaimlerChrysler AG**

“At the same time, we are working on improving our cost structure in order to match the level of our best competitors. However, it would be short-sighted to look only at costs. Our focus is on products. In this area we want to achieve even more with the more efficient use of our resources.”

**Porsche AG**

“In the past fiscal year the company operated at a level of profitability well above any other automobile manufacturer anywhere in the world.

This was made possible by increasing efficiency – a task to which we are unceasingly committed. It includes regular re-examination and optimization of internal structures, continual reductions in the time needed to respond to market changes and ongoing increases in cost saving potential in all the company’s business areas.”

**Arvin Meritor Inc.**

“Improving our cost structure in light of current market dynamics, we took a hard look at our global operations this year and implemented a series of difficult but necessary changes to make the company stronger and more competitive. Most of these changes – which included workforce reductions, and plant closings and consolidations – were either completed or announced this year. As a result, we recorded $117 million of restructuring charges in fiscal year 2005. We are confident that these actions will greatly improve our cost structure, resulting in annual savings of $50-60 million beginning in 2007.

We also addressed the need to focus on our core businesses in order to be a leaner, more flexible and efficient company. We accomplished this in part by divesting certain components of our business that are not an integral
part of our strategy. These divestitures, which generated cash proceeds of $235 million, included:

> Steel coil-coating business – November 2004;
> Stampings and components manufacturing business – December 2004;
> Certain assets of our commercial vehicle off-highway brake business – October 2005.

Also, in October 2004, we announced the decision to sell our Light Vehicle Aftermarket (LVA) business. Later in the fiscal year, market conditions prompted us to change our divestiture strategy.

We announced at that time that we would sell the LVA businesses individually, rather than as a whole, to maximize the return to our shareowners. This has proven to be the right course of action based on the level of interest we have experienced to date.”

Visteon Corporation

“Foremost among the actions that signified our year in 2005 was the completion of an agreement with Ford Motor Company – officially completed on October 1 – that significantly improved Visteon’s competitiveness and cost structure.

This began with the establishment of our restructuring framework, continued with a focus on non-strategic and underperforming operations and eventually led to the development of a three-year roadmap for profitability, which we began implementing in 2005.

Among the plans initiated in 2005 as a result of a more diligent approach and a financially driven mentality:

> Reduced our workforce by more than 1,000 employees in the U.S., Europe and Mexico.
> Exit ed our joint venture with Nichirin in Europe.

> Announced changes to our US salaried benefits, making us more competitive.
> Announced the development of a restructuring plan to address more than 20 underperforming or non-strategic facilities.

As a result of actions taken in 2005, in North America we reduced our average hourly wage from $38 to $17, cut the average plant size from 600,000 to 300,000 square feet, and streamlined the average number of hourly employees at each plant from 680 to a more competitive staffing level of 500.”

Autoliv Inc.

“Our strategy to move production to low-cost countries has been pivotal in offsetting the pricing pressure from customers. In 2005, we decided to move our British airbag assembly primarily to Turkey and most of our Australian seatbelt and webbing production to China. In addition, we closed one plant in France.

We now have 40% of headcount in low-cost countries, compared to 35% a year ago and less than 10% in 1999 when the focus on production reallocation was initiated.”

Denso Corporation

“In addition to these initiatives based on our 2015 Vision, we are also strengthening our ability to overcome international price competition by implementing aggressive rationalization measures. In addition to in-depth efforts to reduce costs and improve production efficiency, we are also using creative rationalization to minimize our costs. For example, we propose and supply products that can be used for multiple types of vehicles.”

Magna International Inc.

“We accelerated our cost reduction plans in 2005, announcing ten plant closures and raising our restructuring-related
expenses above $100 million. The incremental investment in restructuring will provide a more competitive footprint by improving capacity utilization and lowering manufacturing costs.”

People

Most chairmen stress the vital importance of human resources. People are the most important asset and companies have to cope with the challenges they are confronted with.

Arvin Meritor Inc.

“Thanks to the ongoing commitment of our 29,000 employees and a management team that is rich in industry expertise, we made significant progress in positioning the company for long-term success.

Our management team’s diverse industry experience is the motivating force behind Arvin Meritor’s many accomplishments this year.

This group drives the vision for the future that is essential in an industry experiencing such dramatic change.”

Denso Corporation

“We are also expanding our group-wide environmental and social contribution activities and strengthening systems in such areas as disclosure, compliance and respect for employees’ rights. Our aim is to be valued and respected by society as a corporation that lives up to trust placed in it by shareholders, customers, suppliers and business partners, as well as by employees and communities.

We want DENSO to evolve into a corporation that exceeds the expectations of all stakeholders, including the expectation of sustainable business development, to be a model for organizations in many fields.

Eaton Corporation

“Eaton’s commitment to Doing Business Right?

In 2005, our 59,000 employees worldwide helped Eaton produce the best sales and profit numbers in our history. They know that how we achieve the numbers is as important as the numbers themselves. I want to congratulate our employees around the world for their performance in 2005 and dedicate this year’s annual report to them. They make you, our customers and our communities proud.

We are confident in our ability to achieve success because of the strength of our people. Ninety-seven percent of our employees around the world participated in our employee survey again in 2005. Their expressions of pride and commitment to our company and shared values truly have transformed Eaton during the past five years. The biggest reason you can count on Eaton is because you can count on our people.”

GKN plc

“Credit for our successes in 2005 is spread widely throughout the global GKN organisation. People at all levels have been challenged by the execution of our strategic plan and have shown exceptional skill and dedication. I thank them all for their contribution to what has been a memorable year of progress in the development of GKN.”

Johnson Controls Inc.

“Our employees work in more than 50 countries and more than 500 locations, yet we all work together to achieve our mission of exceeding customer expectations.
We’re guided by our corporate Vision, which sets forth our values and the way we do business. We are committed to our customers, to ethical behavior, to a focus on innovation, our communities and the environment, and to continuous improvement in every aspect of our business.

This common bond makes us uniquely Johnson Controls – it differentiates us in the marketplace and gives us competitive advantage.”

**Magna International Inc.**

“In closing, I wish to thank our Board of Directors and management team for continuing to chart a successful course for Magna during a period of transition and turbulence in the auto industry. We will stand by our customers during this period of transition as they seek to regain a competitive edge. I also wish to thank our hard-working and committed employees in 22 countries around the world.”

**Porsche AG**

“It seems almost self-evident to point out that all our projects depend on the availability of highly qualified, motivated employees. Their part in the company’s success has once again been acknowledged by the granting of suitable special payments. In addition, the jobs of all members of the Porsche AG workforce have been secured until the year 2010 by a location assurance agreement, concluded in July 2005. This is a clear acknowledgement of the value of the ‘Made in Germany’ seal of quality and of Germany as a manufacturing location, the positive development of which is important to all of us at Porsche. Our participation in VW is further express confirmation of this policy.”

**Fiat SpA**

“These breakthroughs, as well as all the other operational and financial improvements highlighted in this annual report, could not have been achieved without the strenuous efforts of the entire Fiat community, each and every one of whose members contributed to the re-launch of the Group with dedication and discipline. To do so, the Fiat people had to endorse fundamental changes in attitude, to assume greater responsibility and accountability, and to show their determination to deliver. We would like to express our sincere thanks to all of them.”

**Ethics and corporate governance**

Comments by chairmen reveal an increased sensitivity to issues related to ethics and corporate governance. These topics are discussed in the “Letter to the Shareholders” and specified in separate sections in annual reports.

**BMW Group**

“Code pursuant to §161 of the German Stock Corporation Act to the effect that, apart from a few exceptions (see page 133), the recommendations contained in the German Corporate Governance Code in the version published on 4 July 2003 have been complied with and that the recommendations contained in the new version of the Code issued on 12 July 2005 are being complied with. On a related note, the Supervisory Board also enquired into the ramifications of the changed legal situation for BMW from the beginning of 2006 brought about by the new law, the Management Boards’ Compensation Disclosure Act, and the various options open to it. At its meeting in December 2005, the Supervisory Board also questioned the effectiveness of its own work and investigated ways of improving it.

At its constitutive meeting for the financial year 2004, the Supervisory Board had established a total of three new committees in addition to the Presiding Board. The composition of these committees, which remained unchanged in 2005, is shown on page 126. The Chairman reported regularly to the Supervisory Board on the status of committee work.
Meetings of the Presiding Board focused primarily on preparations for Supervisory Board meetings, in particular where complex issues were concerned. The Presiding Board received reports on the implications of the German Corporate Integrity and Modernisation of the Contestation Act and considered the changes to the Germany Corporate Governance Code.”

Volkswagen AG

“The implementation of the German Corporate Governance Code at Volkswagen was the subject of our meeting on November 11, 2005. In particular, we discussed the changes made to the German Corporate Governance Code by the relevant Government Commission on June 2, 2005. We also discussed the remuneration structure for the Board of Management, which we subsequently confirmed. On December 2, 2005, together with the Board of Management, we issued the declaration required under section 161 of the Aktiengesetz (German Stock Corporation Act) regarding compliance with the recommendations of the Code.”

Honda Motor Company

“As our business grows on a global scale, so does the importance of upgrading corporate governance and increasing the autonomy of our various regional headquarters and business operations. With this in mind, Honda has introduced a new corporate management system.

In the past, members of the Board of Directors were responsible for business execution in their role as directors. However, we have now separated that role into two: the “director” role (supervision and business execution within the Board of Directors) and the “operating officer” role (business execution at the regional level and at each local “spot”). The goal of this change is to enhance the flexibility of the Board of Directors, as well as to accelerate the transfer of authority to each region and each local spot as a means to increase the speed and flexibility of our regional operations.

With this new system in place, we will strive to strengthen both the supervisory and executive functions while targeting swifter, more flexible business operational management.”

GKN plc

“Last year I reported that we had carried out a global survey of our social responsibility behaviour and practice which would enable us to renew and improve the way we interact with employees, customers, suppliers and communities. As a result we are introducing The GKN Code which is supported by a number of policies, some of which are new and some of which are updates of existing policies. The Code is common to all parts of the Group and sets out a clear and unambiguous framework of conduct and behaviour.”

Environmental consideration

Chairmen put a strong emphasis on environmental issues and point out the concrete actions their companies implement to comply with legal and ethical standards as regards this highly sensitive topic.

Honda Motor Company

“We worked hard to enhance the environmental and safety aspects of our automobiles.

In addition to further improving fuel economy in all vehicles, we endeavoured to make the emissions of our vehicles even cleaner. We also expanded our line-up of hybrid models, and in Japan and the United States we began leasing the FCX, a fuel cell vehicle incorporating our original next-generation fuel cell stack, which we developed in-house. In the United States and Canada, we promoted our Safety for Everyone*4 campaign.
In the power products segment, we supplied a variety of items that benefit customers around the world. These included general-purpose engines, generators, pumps, brush cutters, outboard engines and lawnmowers—all designed from the perspectives of safety and the environment. At the same time, we sought to expand our business through a variety of activities. We also developed and promoted a compact, home-use cogeneration unit incorporating a natural gas-powered engine.

In the upcoming fiscal year, we will unveil a next-generation, general-purpose engine incorporating electronic control technologies to improve user-friendliness, offer superb environmental performance and reduce noise. We will also increase the supply of cost-competitive products made in Asia to customers in various other regions. In addition, we will continue to actively promoting our compact, home-use cogeneration unit, which greatly reduces environmental impact, to users in Japan and overseas.

Through these initiatives, we will seek to further develop our power products business. At the same time, we recognize the importance of ongoing improvements in the safety and environmental performance of our products.

We will continue to actively allocate the Company’s resources to developing attractive models in our automobile business, as well as to enhancing the appeal of our motorcycles and power products. We will strive to further improve the power, fuel efficiency and environmental performance of our gasoline and diesel engines, while conducting aggressive R&D on hybrid technologies, which will grow in importance, together with fuel cell and other technologies.”

**General Motors**

“We continue to put significant resources into technology, particularly in improving fuel efficiency. [...] While these are great solutions to help reduce emissions and improve fuel economy over the near-term, we continue to commit significant resources in the development of hydrogen fuel cells. We realize that there’s no shortage of sceptics of hydrogen propulsion. [...]”

**Porsche AG**

“Another topic area with relevance to a secure future is being given close attention: the growing demand for environmentally acceptable forms of vehicle propulsion. By the end of this decade we will therefore be introducing a Cayenne with hybrid driveline – a joint development project with the Volkswagen Group. It should be noted, incidentally, that only cooperation of this kind offers Porsche a practicable economic basis for such a project to be undertaken.”

**Denso Corporation**

“A key environmental technology is CRS, which further improves diesel’s fuel efficiency while reducing harmful substances in the exhaust gas. With 1,800-bar pressure and up to five-time multiple injections during each combustion stroke, DENSO’s CRS is among the most advanced in the world. Demand is expanding, especially in Europe, Asia and Oceania. We are currently preparing an even cleaner CRS. This new technology will further strengthen DENSO’s presence in Europe and other markets.”

**Valeo SA**

“Environmental protection is increasingly important to today’s drivers, who tend to be more willing to invest in vehicles that feature environmentally friendly technologies such as micro-hybrid Start-Stop or cam less engine systems that significantly reduce fuel consumption and pollutant emissions, as well as noise levels, while retaining full driving comfort. Cabin air filtration and purification is another key area to ensure driving comfort and the well-being of vehicle occupants, and Valeo is a leading player in this area as well.”
Johnson Controls Inc.

“Our commitment to successfully manage Johnson Controls with a focus on sustainability was recognized in 2005 with our inclusion on the Dow Jones Sustainability World Index, made up of a select group of companies from around the world recognized for their long-term financial, social and environmental achievements.

We also received the EPA Climate Protection Award recognizing our efforts to reduce greenhouse gas emissions through our innovative utility bill tracking system.”

Opportunities in China, Asia-Pacific and Eastern Europe

China and Asia-Pacific are still identified by nearly all chairmen as key growth regions. Strategic challenges consist in developing their companies’ presence and building up a key player position in these markets. Another region attracting particular focus is Eastern Europe where several companies plan to reinforce their position.

Honda Motor Company

“In China and elsewhere in Asia, the automobile market continued to expand, and we achieved remarkable growth thanks to the high profile of the Honda brand.

While China has seen spectacular growth in demand for passenger vehicles, the pace of expansion has moderated since the central government tightened monetary policy and adopted other measures last April. Nevertheless, Honda believes that demand will continue growing, and that China has great potential to become the world’s largest automobile market after the United States. A number of existing models are selling well in this important market, including the Accord and Fit series. In 2006, we will seek to further increase sales by adding the new Civic to our line-up.

With respect to local production in China, by the end of 2006, we will raise our total capacity—the combined capacity of two local affiliates, Guangzhou Honda Automobile Co., Ltd., and Dongfeng Honda Automobile Co., Ltd.—from 270,000 to 480,000 units per year. In April 2005, Honda Automobile (China) Co., Ltd., a subsidiary devoted exclusively to making automobiles for export, started mass-producing the Jazz model for the European market, with exports beginning in June. These efforts reflect Honda’s strategy of broadening its automobile business in China.

Meanwhile, India, Indonesia and other Asian markets continue to grow. Our plan is to increase sales in those areas, centering on such highly regarded models as the Jazz and Fit.

We will also expand production capacity to meet rising demand. In Asia, we are targeting unit sales in fiscal 2006 of 540,000 automobiles, up 5.5%.”

Porsche AG

“The Cayenne has already demonstrated most effectively that Porsche can access new customer groups successfully. On new markets such as China or Russia, which we are currently penetrating most determinedly, this sports off-road vehicle is the main attraction in our sales program.”

Ford Motor Company

“We are doing especially well in Russia, Turkey and Hungary. Last October I travelled to India to help introduce Ford Fiesta, our most important new product there in years. Ford sales in China, the fastest growing market in the world, were up 46 percent in 2005.”

Peugeot Citroën SA

“In 2005, we also reached an important milestone in our expansion outside Western Europe, where, for the first time, sales topped one million units, accounting for more
than 30% of total sales and revenue. Unit sales rose sharply in South America and China, driving a clear improvement in financial performance. This growth dynamic is set to continue, led by the introduction of a large number of new models tailored to local demand.”

**Autoliv Inc.**

“Over the past five years we have invested aggressively in Asia. With these investments, our market share in Japan has grown to nearly 20% and to even higher market shares in Korea and Driving on China. Equally important is the superior global customer mix that we have attained through this expansion [...]. Many Asian vehicle manufacturers have set up production in North America and Europe and now take market share from our traditional customers. For continued success, it is therefore crucial that we have strengthened our presence in Asia and among the Asian vehicle manufacturers.

In 2006, we expect to strengthen our superior presence in the Asian markets. We are currently building three new plants in China for steering wheels, electronics and gas generators.

We are committed to continuing consolidating our supplier base. As existing long-term contracts expire, we will gradually reduce the number of suppliers from over 2,000 to around 500. The move of our production to low-cost countries will continue, but the greatest cost savings potential could be realized by purchasing more of the components we need in low cost countries. Before the end of this decade, we intend to source 50% of our purchase cost in these countries compared to our current level of “only” 20% and less than 15% a year ago.”

**Visteon Corporation**

“To expand capacity in these markets, we began construction on compressor plants in China and Mexico, and a manufacturing facility in Slovakia. We added joint ventures with ChangAn and TYC Auto Lamps in China, and with Tata AutoComp Systems in India.

A globally balanced engineering footprint – including research laboratories and innovation centers in such key emerging markets as China, Korea and India.”

**Continental AG**

“We are continually expanding our production facilities in low-cost countries, and have extended our production capacity in the Czech Republic, Malaysia, Mexico, the Philippines, Romania and Slovakia. Our new plant in Brazil will manufacture its first passenger and truck tires in 2006. ContiTech and Automotive Systems are already well represented in China. In Shanghai, we opened Asian headquarters for all divisions that also incorporate a new sales company for both tire divisions.”

**Arvin Meritor Inc.**

“Multi-year contract to provide a leading automotive manufacturer in China with a complete sealed door module for China’s domestic market; shipments are scheduled to start in October 2006 Commercial Vehicle Systems, led by Tom Gosnell, saw record sales and volumes this year, with a resulting operating income improvement of 18 percent over the prior year. We were also successful in further diversifying our customer base and expanding into new regions of the world.”

**Michelin Group**

“The fast developing Asian economies, China, India and the ASEAN in particular, offer high growth prospects for mobility markets, especially road-based mobility. Our Company has every intention of taking full advantage of this growth potential and of investing substantially in new manufacturing capacity to be able to serve these
new markets, just as it does in Eastern Europe, Russia and South America.”

Predictions
Most chairmen point out that 2006 will continue to be characterised by a difficult economic environment. However they show a cautious optimism by hinting at the positive impacts resulting from industrial restructuring, efforts made around product innovation and diversification of model portfolio.

Renault SA
“The year ahead of us will be decisive. The business environment is difficult and we will be bringing only two new models to market. But it will also be a beginning as we lay the groundwork for future vehicles and deploy our midterm business plan – Renault Commitment 2009. This growth plan aims to make and sustain Renault as the most profitable European volume car company. To achieve this ambition, we will take the offensive with a product drive that is unprecedented in the history of Renault.”

Fiat SpA
“At Group level, we aim to deliver positive cash flow from operations, a trading profit between 1.6 and 1.8 billion euros, and net income of about 700 million euros. While we do not expect market conditions for our operating Sectors to change materially this year, we have set high trading margin targets (trading profit as a percentage of revenues) for all of them: 7% to 7.5% at CNH, 5.5% to 6% at Iveco, and 3.5% to 4% in Components and Production Systems. The Automobile Sector should also turn in a positive performance, with a trading margin of 0.5% to 1%. This result will be supported by the full-year contribution of new models already rolled out. These will be joined in coming months by other new models, as we implement our aggressive product renewal plan calling for the launch of 20 new cars and the restyling of 23 current models between 2005 and 2008.”

General Motors
“As this report was going to print, GM was exploring the possible sale of a controlling interest in our financial services subsidiary, GMAC, with the goal of strengthening its credit rating and renewing its access to low-cost financing. GM also was involved in important discussions with Delphi Corp. and the United Auto Workers on issues surrounding Delphi’s Chapter 11 restructuring. We are pursuing an agreement in the best interests of GM and its stockholders, and that enables Delphi to continue as an important supplier to GM.”

Honda Motor Company
“Looking at the operating environment, we believe that the world economy will continue growing, especially in the United States and Asia, but there are concerns that the rate of growth will slow. Uncertainties will remain in such areas as the global geopolitical situation, oil and raw materials prices and foreign exchange movements. Even in Japan, where economic recovery is steady and personal consumption is expected to grow significantly, we believe that sales competition will further intensify.”

Peugeot Citroën SA
“In this renewal process, the first-half introductions of the Peugeot 207 and Citroën C6 are the big news for now, but they will be followed by other major launches during the year both in and outside Western Europe. Together, they will again demonstrate our ability to innovate and diversify
our model portfolio, which will include 38 body styles in 2006 versus 28 in 2001. These new model launches will have a positive impact in 2006, but the business environment is expected to remain unfavourable, with persistently aggressive competition and flat demand in Europe. In this environment, we estimate that operating margin should be in the neighbourhood of the second-half 2005 figure in first-half 2006, before showing an improvement in the second six months of the year.”

GKN plc

“There is a broadly stable outlook for major automotive markets whilst aerospace markets look set to remain strong. In Automotive, industry forecasts for North American and Western European markets are for little change in production volumes, although there remains some risk of disruption to the former following recent supplier insolvencies. However, developing markets, especially in Asia Pacific, are expected to show continuing strong growth. Prices for steel and other automotive raw materials appear to have stabilised although energy costs are still showing some increase. With its presence in emerging markets and strategic restructuring programme nearing completion, Driveline should have another solid year. Powder Metallurgy expects to show further recovery and growth. Results for our other smaller automotive businesses will be impacted by redundancy costs. [...] Overall we expect to continue the progress seen last year into 2006, with the further benefits of restructuring together with the strength of our order book accelerating growth from 2007 onwards.”

Autoliv Inc.

“During the first quarter, light vehicle production in the Triad is expected to increase by 2%. However, light vehicle production in Western Europe is expected to decline by 1% with a significant negative model mix effect for us. Currency effects are expected to reduce our sales by 5%. Consequently, sales are expected to decline by 8%. Despite this decline, operating margin is expected to improve from the 7.6% level recorded in the first quarter 2005, and operating income is expected to exceed the $129 million recorded in the same quarter 2005. During the full year 2006, light vehicle production in the Triad is expected to increase by 1% despite a 2% decline in Western Europe with a negative vehicle model mix. The decline in our sales in the first quarter is expected to diminish already in the second quarter, and during the fall sales are expected to start to pick up gradually with a positive momentum into 2007. As a result, we expect organic sales for 2006 to be relatively flat. Interest expense, net should be favourably impacted by the Jobs Act transaction in 2005 and by Autoliv’s Eurobond coming to maturity in May 2006. These transactions could potentially reduce interest expense in 2006 by approximately $15 million, given current exchange rate and interest rate differences in Sweden and the US. However, this favorable effect may be offset by higher market interest rates and a higher average net debt due to the share repurchases. Consequently, we expect a healthy growth in earnings per share despite a challenging vehicle production.”

Valeo SA

“We are expecting a slight drop in automotive production in our reference markets this year, along with continued instability in the raw materials market. There will also be further restructuring within certain automakers and suppliers, particularly in the USA.
For Valeo to succeed in this challenging environment, we must stay focused on the key points of our 2010 strategy: technological innovation, business development, operational excellence and human resources.

Overall, our main objectives for 2006 are to achieve sales growth higher than that of our reference markets and improve the return on our invested capital, by continuing to optimize our purchasing and industrial organization, raising quality standards and maintaining strict asset management.

Although raw material prices will continue to rise in 2006, we are working harder than ever to offset their negative impact on the Group’s results and get back on track to higher margins and profitability.

I would like to take this opportunity to thank our shareholders, customers, suppliers and most of all our employees for their continued commitment and support. Through the rigorous implementation of our 5 Axes methodology and the deployment of a Total Quality mindset throughout the organization, we are determined to achieve our goal of becoming one of the world’s top five automotive suppliers by 2010.”

Continental AG

“Studies by various independent business analysis institutes forecast that the number of automotive suppliers will fall from around 5,600 at present to 2,800 in the next ten years. We aim to play an active role in this consolidation process – which is why innovative strength, balanced cost structures, and the systematic implementation of our corporate strategy geared towards profitable growth are essential. We monitor our costs while striving for growth so we can continue to operate as an independent company on the global market in the future.

Traffic safety is an important and wide-ranging issue. We are convinced that it will gain further significance as a result of electronics in particular. For example, the proportion of vehicles fitted with ESC systems is continually increasing. Our work will thus continue to focus on safety and driving comfort because we are extremely well positioned for the future in these areas.”

Eaton Corporation

“For the 2005-2010 time period, our new targets are:
> 10 percent compound growth in revenues;
> 15 percent compound annual growth in earnings per share;
> Further enhancement of our cash flow through the retention of 9 percent annual revenues in free cash flow;
> And 15 percent return on invested capital.

We recognize that these are challenging goals and that they stretch us to work harder and smarter together. They are just the kind of goals necessary to continue to propel our company forward, while Doing Business Right.”

Magna International Inc.

“I believe that there is recognition within the auto industry that there must be a major correction and it is my hope that the necessary changes will take place. In North America, I believe it is important that the major North American-based auto manufacturers and the unions sit down and create a framework for a better relationship that will allow them to be more competitive. Many of the fundamental problems facing the North American industry can only be solved if the auto manufacturers and the unions are willing to develop a new relationship and work together to preserve jobs. This is also generally true in Europe. We at Magna are hopeful this will happen and are willing to play a constructive role in ensuring that some of the major players in the
North American and European automotive markets regain their competitiveness.”

**TRW Automotive Holdings Corporation**

“The global automotive industry is changing at a rapid pace.

Competition for market share among vehicle manufacturers in the major vehicle producing regions continues to intensify and is reshaping the vehicle and component industry.

Many of the challenges we faced last year will again be center stage in 2006. We expect significant profit pressures relating to customer demands for price reductions, higher commodity costs, customer and supplier solvency issues and rising interest rates.

The demand for safety products is critical to sustaining our growth, as we expect minimal vehicle volume increases in Europe and North America over the foreseeable future.

The sales generated from safety products along with the benefits derived from our cost reduction programs and past restructuring actions are expected to help mitigate many of the negative industry pressures that we are experiencing.

With that backdrop, the level of uncertainty surrounding the 2006 environment is daunting, as severe economic strain continues to take its toll on the automotive industry.

For the 2006 year, we have committed to a plan that will test our highly disciplined operational programs and will require good execution to achieve. We are ready to meet those tests and I look forward to reporting our progress to you during 2006.”

**Hyundai Motor**

“Hyundai Motor Company forecasts investment to total 3.436 trillion Korean won in 2006, an increase of 27.6 percent from the previous year and sales revenue to reach 41.4 trillion Korean won, a rise of 18.8 percent from the previous period. By reaching such lofty targets, Hyundai Motor Company will strive to meet profitable targets in the rapidly changing global market.

Sales targets for the current year have been set as 2.689 million automobiles, an increase of 15.1 percent from the previous year and encompassing a domestic production of 1.767 million automobiles and 922,000 automobiles from overseas production facilities respectively.

Through the expansion of the Hyundai line-up and dealer networks in overseas sales markets, Hyundai Motor Company expects a continued strengthening of brand value and has set regional sales targets of 532,000 automobiles for the U.S.A, 354,000 for Western Europe, 300,000 for China and 280,000 for India.

Hyundai Motor Company plans the launch of 2-3 new models per region this year in these markets and will continue to strive forward in all international markets.

As the domestic market has fallen into a state of stagnation over the last several years, the whole industry has been faced with many difficulties. Expected to be a front-runner in the road to recovery this year, Hyundai Motor Company plans to strengthen its business capacity acting as the active agent of growth in order to help revitalize the overall business climate. Through the increase in product quality and the strengthening of Customer Satisfaction Management, Hyundai Motor Company has set a lofty target of 630,000 automobiles to be sold in the domestic market, an increase of 10.6 percent from the previous fiscal year. [...] With that in mind Hyundai Motor Company will overcome the current difficult economic climate prudently, using the current crises as an opportunity to reinforce the state of the company.”
Automotive Industry Financial Disclosures

The excerpts that follow are intended for those who wish to gain an understanding of typical financial disclosures for an automotive company. We have chosen our selections from the footnotes of the financial statements. These disclosures have been prepared according to a variety of generally accepted accounting principles, which we will not attempt to explain in detail here.

Consolidation - Joint Ventures

IAS 31 (1998), Financial Reporting of Interests in Joint Ventures, prescribes the accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income, and expenses in the financial statements of venturers and investors. In the United States, accounting for investments in joint ventures is primarily prescribed in APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. IAS 31 and Opinion 18 similarly define a joint venture relationship and use a similar notion of joint control as the basis for that relationship. However, IAS 31 requires that a contract exist between the venturers in order to qualify as a joint venture, whereas Opinion 18 does not. Thus, if a contract does not exist, the relationship may qualify as a joint venture under the requirements of Opinion 18 but not under those of IAS 31.

The IASC prescribes different accounting requirements for investments in three broadly defined types of joint venture: jointly controlled entities, jointly controlled assets, and jointly controlled operations. Opinion 18 prescribes accounting only for corporate joint ventures (which would be classified as one type of jointly controlled entity under IAS 31). The basic accounting for jointly controlled entities prescribed by IAS 31 differs from that of Opinion 18.

Opinion 18 requires the use of the equity method of accounting for corporate joint ventures, whereas the benchmark treatment in IAS 31 requires the use of the proportionate consolidation method. However, IAS 31 permits the equity method of accounting as an allowed alternative treatment for jointly controlled entities. As a consequence, reporting by an investor in a joint venture may be significantly different depending on which standard is applied and which alternative is selected under IAS 31.

Illustrative disclosures

Valeo SA

“[…] 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 of income and expense is aggregated, lineby-line, with similar items in its consolidated financial statements.

All significant inter-company transactions are eliminated (for joint ventures the elimination is performed to the extent of the Group’s ownership interest in the company), as are gains on inter-company disposals of assets, inter-company profits included in inventories and Inter-company dividends. […]"
Valeo Raytheon Systems Inc.

The Group continued to invest in Raytheon Systems Inc., increasing its stake from 66.6% at December 31, 2004 to 73.1% at December 31, 2005. Valeo owns Raytheon Systems Inc. jointly with the Raytheon Group, and accounts for its interest by the proportional consolidation method because of the characteristics of the partnership agreement.

This transaction did not impact Group sales. […]

Valeo Armco Engine Cooling Co.

Valeo acquired an interest of 51% in the joint venture Valeo Armco Engine Cooling Co., with the remaining 49% of capital held by the Armco group. This joint venture, which has been proportionally consolidated, will manufacture engine cooling systems. The acquisition had no impact on 2005 sales. […]

[…] The consolidated financial statements include transactions carried-out in the normal course of business between the Group and its joint ventures. These transactions are carried out at market prices.

### (In millions of euros)

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of goods and services</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td>Purchases of goods and services</td>
<td>(9)</td>
<td>(12)</td>
</tr>
<tr>
<td>Dividends received</td>
<td>4</td>
<td>9</td>
</tr>
</tbody>
</table>

### At december 31

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating receivables</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Operating payables</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

Fiat SpA

**“Jointly controlled entities**

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. […]

Interests in joint-ventures (20 companies) are accounted for using the equity method, except for one investment accounted for using proportionate consolidation, although the amounts involved in this case are not significant. The main aggregate amounts related to the Group interests in joint ventures accounted for using the equity method are as follows:

### At December 31

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets</td>
<td>1,064</td>
</tr>
<tr>
<td>Current assets</td>
<td>1,413</td>
</tr>
<tr>
<td>Total assets</td>
<td>2,477</td>
</tr>
<tr>
<td>Financial debt</td>
<td>710</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>1,062</td>
</tr>
<tr>
<td>Net revenues</td>
<td>3,464</td>
</tr>
</tbody>
</table>
As of May 2005, the operations that had previously been transferred to the Fiat-GM Powertrain joint venture were consolidated in Fiat Powertrain Technologies. Fiat re-acquired full control of these operations upon termination of the Master Agreement with General Motors, with the sole exception of the Polish operations that continue to be jointly managed with General Motors. The Powertrain businesses of Iveco, C.R.F. (Fiat Research Centre) and Elasis will subsequently be transferred to Fiat Powertrain Technologies.

At the end of 2005, the Fiat Group acquired Enel's share of the joint venture Leasys S.p.A., whose activity is the hire and management of company car fleets, thereby obtaining 100% control. The balance sheet of this company has been consolidated from December 31, 2005.

### Arvin Meritor Inc.

“[…] Consolidation and Joint Ventures

The consolidated financial statements include the accounts of the company and those majority-owned subsidiaries in which the company has control. All significant intercompany balances and transactions are eliminated in consolidation. The balance sheet and results of operations of controlled subsidiaries where ownership is greater than 50 percent, but less than 100 percent, are included in the consolidated financial statements and are offset by a related minority interest expense and liability recorded for the minority interest ownership. Investments in affiliates that are not controlled or majority-owned are reported using the equity method of accounting (see Note 12). The company’s consolidated financial statements also include those variable interest entities in which the company holds a variable interest and is the primary beneficiary. […]

<table>
<thead>
<tr>
<th>September 30</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>$366</td>
<td>$292</td>
</tr>
<tr>
<td>Non-current assets</td>
<td>199</td>
<td>162</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$565</strong></td>
<td><strong>$454</strong></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>$263</td>
<td>$211</td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td>56</td>
<td>44</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>$319</strong></td>
<td><strong>$255</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$1,488</td>
<td>$1,100</td>
</tr>
<tr>
<td>Gross profit</td>
<td>159</td>
<td>121</td>
</tr>
<tr>
<td>Net income</td>
<td>69</td>
<td>56</td>
</tr>
</tbody>
</table>

### Johnson Controls Inc.

“[…] Investments in partially-owned affiliates are accounted for by the equity method when the Company’s interest exceeds 20 percent. Under certain criteria as provided for in FASB Interpretation No. 46(R), “Consolidation of Variable Interest Entities”, the Company may consolidate a partially-owned affiliate when it has less than a 50% ownership. […]

On April 1, 2005, the Company deconsolidated a North American interior experience joint venture as it was determined the Company no longer had effective control over the venture’s operating activities. Subsequent to April 1, 2005, the Company determined that based on SFAS 94, “Consolidation of All Majority-Owned Subsidiaries,” the joint venture should not have been consolidated in prior periods. As such, the Company’s financial statements have been restated to account for the joint venture on an equity basis in accordance with APB 18, “The Equity Method of Accounting for Investments in Common Stock” for all periods prior to April 1, 2005. […]”
Revenue recognition

For revenue to be recorded in the income statement under IFRS, the seller must transfer to the buyer the significant risks and rewards of ownership. Additionally, it must be probable that the economic benefits associated with the transaction will flow to the enterprise and the amount must be reliably measurable. US GAAP focuses more on revenues being realised (either converted to cash or cash equivalents or the likelihood of its receipts is reasonably certain) and earned (no material transaction pending and the related performance has occurred). Additional guidance for SEC registrants sets out four criteria to be met before revenue is considered to be realised and earned:

> Persuasive evidence of an arrangement exists;
> Delivery has occurred or services have been rendered;
> The seller’s price to the buyer is fixed or determinable;
> Collectibility is reasonably assured.

Illustrative disclosures

Renault SA

“Sales and margin recognition

Sales of goods are recognized when vehicles are made available to the distribution network in the case of non-Group dealers, or upon delivery to the end-user in the case of direct sales. The margin on sales is recognized immediately for normal sales by the Automobile division, including sales with associated financing contracts that can be considered as finance leases (long-term or with a purchase option). However, no sale is recognized when the vehicle is covered by an operating lease from a Group finance company or the Group has made a buy-back commitment, when the term of the contract covers an insufficient portion of the vehicle’s useful life.

In such cases, the transactions are recorded as operating leases and included in sales of services. The difference between the price paid by the customer and the buy-back price is treated as rental income, and spread over the period the vehicle is at the customer’s disposal. The production cost for the new vehicle concerned is recorded in inventories for contracts of less than one year, or included in property, plant and equipment under vehicles leased to customers when the contracts exceed one year. The sale of the vehicle as second-hand at the end of the lease gives rise to recognition of sales revenue and the related margin. As soon as a loss is expected on the resale, a provision (if the vehicle is in inventories) or additional depreciation (if the vehicle is included in property, plant and equipment) is recognized to cover the loss.

Sales incentive programs

When based on the volume or price of the products sold, the cost of these programs is deducted from revenues
when the corresponding sales are recorded. Otherwise, the cost is included in selling, general and administrative expenses. If programs are approved after the sales, a provision is established when the decision is made. The Group sometimes organizes promotional campaigns offering reduced interest loans to end-users. This expense is recognized immediately when the rates offered cannot cover refinancing and administration costs, and spread over the duration of the loan otherwise. […]”

**General Motors**

“Sales generally are recorded when products are shipped (when title and risks and rewards of ownership have passed), or when services are rendered to independent dealers or other third parties. Provisions for dealer and customer sales incentives, customer leasing incentives, allowances, and rebates are made at the time of vehicle sales. Incentives, allowances, and rebates related to vehicles previously sold are recognized as reductions of sales when announced.

Sales to daily rental car companies with guaranteed repurchase options are accounted for as equipment on operating leases. Lease revenue is recognized over the term of the lease. […]”

**Visteon Corporation**

“Sales are recognized when there is evidence of a sales agreement, the delivery of goods or services has occurred, the sales price is fixed or determinable and collectibility is reasonably assured, generally upon shipment of product to customers and transfer of title under standard commercial terms. Significant retroactive price adjustments are recognized in the period when such amounts become probable. Sales are recognized based on the gross amount billed to a customer for those products in which the Company’s customer has directed the sourcing of certain raw materials or components used in the manufacture of the final product.”

**Valeo SA**

“Operating revenues are comprised of net sales and other operating revenues.

Net sales primarily include sales of finished goods and also include all tooling revenues. Sales of finished goods and tooling revenues are recognized at the date on which the Group transfers substantially all the risks and rewards related to ownership to the buyer and is no longer involved in the management or in the effective control of the goods sold. In cases where the Group retains control of the future risks and rewards related to tooling, any customer contributions are recognized over the duration of the project, over a maximum of 4 years.

Other operating revenues consist of all revenues for which the associated costs are recorded below the gross margin line. They mainly comprise sales of prototypes and contributions received from customers to development costs. Such contributions are deferred as appropriate and are taken to income over the period of sale of the corresponding products, over a maximum of 4 years.”

**Faurecia**

“Sales are recognized when the risks and rewards of the ownership of the modules or parts produced are transferred. This generally corresponds to when the goods are shipped, or – in the case of development contracts or the sale of tooling – when the technical stages are validated by the customer.”
Research and development costs

US GAAP and IFRS defer significantly on the treatment of development costs. US GAAP requires research and development costs to be expensed as incurred. EITF 99-5 authorizes capitalization of certain tooling development costs when the customer contractually guarantees reimbursement. IAS 38 for intangible assets establishes that the criteria for the recognition of an asset are met when:

a) It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise;

b) The cost of the asset can be measured reliably.

Because research or conception costs consist mostly in investigation undertaken with the prospect of gaining new technical knowledge, their probable future economic benefits cannot be ascertained. Thus research costs should be expensed as incurred.

As far as development costs are concerned, when their technical feasibility is demonstrated, when the intention to complete the asset is proven, as well as the ability to use or sell the intangible and the future profitability can be demonstrated, these costs must be capitalised and amortised over the life of the program.

Illustrative disclosures

Continental AG

“Research and development expenses

Research and development expenses comprise expenditure on research and development that does not meet the criteria for recognition as an asset in accordance with IAS 38. Advances and reimbursements from customers are netted against expenses at the time they are invoiced.

Development costs

Expenses incurred from the application of research findings for the development of new or substantially improved products are deferred as assets for the period until the developed product can be sold, and then amortized over three years, provided the six criteria set out in IAS 38 are met. To the extent that these expenses are only for customer-specific applications, pre-production prototypes, or tests for products already being sold (application engineering), these expenses do not qualify as development activities which may be recognized as an intangible asset. New developments for the original equipment business are not marketable until we have been nominated as the supplier for the particular vehicle platform or model and, furthermore, have successfully fulfilled pre-production release stages. Moreover, these release stages serve as the prerequisite to demonstrate the technical feasibility of the product, especially given the high demands imposed on comfort and safety technology.

Accordingly, development costs are recognized as an asset only as of the date of nomination as supplier and fulfilments of a specific pre-production release stage. The development is considered to be completed once the final approval for the unlimited series production is granted. Advances and reimbursements from customers are netted against expenses at the time they are invoiced. [...].”

Faurecia

“The Faurecia Group incurs certain development costs in connection with producing and delivering modules for specific customer orders which are either a) not sold to the customer, or b) paid for by the customer on delivery of each part, without the customer guaranteeing full financing of the costs incurred. In accordance with IAS 38, these development costs are recorded as an intangible asset where the company concerned can demonstrate:
> Its intention to complete the project as well as the availability of adequate technical, financial and other resources to complete the development;
> How the customer contract will generate probable future economic benefits and the company’s ability to measure these reliably;
> Its ability to measure reliably the expenditure attributable to the contracts concerned (costs to completion).

These capitalized costs are amortized to match the quantities of parts delivered to the customer, over a period not to exceed five years except under exceptional circumstances. Research costs, and development costs that do not meet the above criteria, are expensed as incurred.”

**Valeo SA**

“Innovation can be analyzed as either research or development. Research is planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development is the application of research findings with a view to creating new products, before the start of commercial production. Research costs are recognized in expenses in the year they are incurred.

Development expenditure is capitalized where the Group can demonstrate:
> That it has the intention, and the technical and financial resources to complete the development;
> That the intangible asset will generate future economic benefits;
> And that the cost of the intangible asset can be measured reliably.

Capitalized development costs are then amortized over a maximum period of 4 years from the start of volume production. Impairment losses may, as required, be recognized in respect of capitalized development costs. […]”

**Autoliv Inc.**

“Research and development and most engineering expenses are expensed as incurred. These expenses are reported net of royalty income and income from contracts to perform engineering design and product development services. Such income is not significant in any period presented. Certain engineering expenses related to long-term supply arrangements are capitalized when the defined criteria, such as the existence of a contractual guarantee for reimbursement, are met. The aggregate amount of such assets is not significant in any period presented.”

**Peugeot Citroën SA**

“Under IAS 38 – Intangible Assets, development expenditure is recognized as an intangible asset if, and only if, the enterprise can demonstrate in particular:
> Its intention to complete the intangible asset and use or sell it, as well as the availability of adequate technical, financial and other resources for this purpose;
> That it is probable that the future economic benefits attributable to the development expenditure will flow to the enterprise;
> That the cost of the asset can be measured reliably.

Automobile Division development expenditure on vehicles and mechanical parts (engines and gearboxes) incurred between the styling decision (project launch for mechanical parts) and the start-up of pre-series production is recognized in intangible assets. It is amortized from the Start of Production date over the useful lives of the related assets, up to seven years for vehicles and over ten years for mechanical parts. The capitalized amount includes payroll costs of personnel directly assigned to the project, the cost of prototypes and the cost of external services related to the project. These costs do not include any overhead or
indirect expense, such as rent, building depreciation and information system utilization costs. The capitalized costs also include the portion of qualifying development expenditure incurred by PSA Peugeot Citroën under a cooperation agreement that is not billed to the partner. All development expenditure billed to PSA Peugeot Citroën by its partners under cooperation agreements is also capitalized.

The Automotive Equipment Division performs development work for all programs covered by specific customer orders. Where development costs are paid in proportion to parts delivered to the customer, with their full recovery being subject to an unguaranteed minimum level of orders placed by the customer, the costs incurred during the period between the customer’s acceptance of the commercial offer and the Start of Production date of the parts or modules are recognized in intangible assets. The intangible asset is amortized based on the quantity of parts delivered to the customer, provided that accumulated amortization at each year-end does not represent less than the amount that would be recognized if the asset were amortized on a straight-line basis over five years. If the contract includes a payment guarantee, the development costs are recognized in inventories and work-in-progress.

Other research and developments expenditure is recognized as an expense for the period in which it is incurred. […]”

**Volkswagen AG**

“[…] Development costs for future products and other internally generated intangible assets are capitalized at cost, provided manufacture of the products is likely to bring the Volkswagen Group an economic benefit. If the criteria for recognition as assets are not met, the expenses are recognized in the income statement in the year in which they are incurred.

Cost includes all costs directly attributable to the development process as well as appropriate portions of development-related overheads. Borrowing costs are not capitalized. The costs are amortized using the straight-line method from the start of production over the expected life cycle of the models or components developed – generally between five and ten years.

Amortization recognized during the year is allocated to the relevant functions in the income statement. […]”

**Renault SA**

“Development expenses incurred between the approval of the decision to begin development and implement production facilities for a new vehicle or part (e.g. engine or gearbox) and the subsequent approval of the design for mass production are capitalized as intangible assets. They are amortized on a straight-line basis from the date of approval for production, over the expected market life of the vehicle or part, up to a maximum period of seven years.

Expenses incurred before the formal approval of product development are recorded as costs in the period they are incurred, in the same way as research expenses. Expenses incurred after the start of mass production are treated as production costs.”
Impairment of intangible and long-lived assets

The key differences between IAS 36 and SFAS 142 and 144 are the measurement bases used to trigger recognition of impairment and the requirement to recognise reversals of impairment losses in subsequent years. It should be remembered that both IAS 36 and SFAS 142 and 144 deal with very subjective estimates (estimates of future cash flows, measurement of impairment trigger, timing of impairment recognition, measurement of fair value, etc.) and that application of either standard on its own will not result in full comparability (i.e., US GAAP financial statements of different entities might not be comparable even though the entities both apply the general principles of SFAS 142 and 144).

FAS 142 establishes that an intangible asset that is not subject to amortisation shall be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test shall consist of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss shall be recognised in an amount equal to that excess. After an impairment loss is recognised, the adjusted carrying amount of the intangible asset shall be its new accounting basis. Subsequent reversal of a previously recognised impairment loss is prohibited.

FAS 144 established that an impairment loss on tangible assets shall be recognised only if the carrying amount of a long-lived asset (asset group) is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset (asset group) is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset (asset group) is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset (asset group). That assessment shall be based on the carrying amount of the asset (asset group) at the date it is tested for recoverability, whether in use (paragraph 19) or under development (paragraph 20). An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset (asset group) exceeds its fair value.

IAS 36 establishes that if, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. This reduction is an impairment loss. The definition of “the recoverable amount” under IAS 36 differs from under US GAAP as being the higher of the fair value of an asset less cost to sell it and its value in use. For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer’s cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquire’s are assigned to those units or groups of units. A cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired, by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. An impairment loss shall be recognised for a cash-generating unit (the smallest group of cash-generating units to which goodwill or a corporate asset has been allocated) if, and only if, the recoverable amount of the unit (group of units) is less than the carrying amount of the unit (group of units).
Illustrative disclosures

Ford Motor Company

“Discontinued and Held-for-Sale Operations. We perform an impairment test on an asset group to be discontinued, held for sale, or otherwise disposed of when management has committed to the action and the action is expected to be completed within one year. […]

Long-Lived Assets. We monitor the carrying value of long-lived asset groups held and used for potential impairment when certain triggering events have occurred. These events include current period losses combined with a history of losses or a projection of continuing losses, or a significant decrease in the market value. The asset group fair value is measured relying primarily on the discounted cash flow methodology. Additionally, we consider various market multiples (e.g., revenue and EBITDA) within the same industry. […]

During 2005, we updated our PAG Improvement Plan for the Jaguar/Land Rover operating unit within our Ford Europe and PAG segment. We project a decline in net cash flows for the Jaguar/Land Rover operating unit based on updated market projections primarily reflecting recent market performance for Jaguar. As a result, we tested the long-lived assets of this operating unit for recoverability and recorded a pre-tax impairment charge of $1.3 billion in cost of sales as the carrying value of these assets exceeded the fair value.

During the fourth quarter of 2005, we reviewed the Way Forward plan for the Ford North America business unit of our The Americas segment. The Way Forward plan was approved in the first quarter of 2006. In the fourth quarter of 2005, we tested the long-lived assets of the Ford North America business unit for recoverability using net cash flows revised for the Way Forward plan. We concluded the long-lived assets of Ford North America are not impaired.

As a result of these actions, we also re-evaluated our annual goodwill impairment test performed in the second quarter of 2005 and have determined that an impairment charge is not warranted. […]

Our policy is to perform annual testing on goodwill and certain other intangible assets to determine if any impairment has occurred. The test is conducted on a reporting unit level that is aligned with our current senior management structure. To test for impairment, the carrying value of each reporting unit is compared with its fair value. Fair value is estimated using the present value of free cash flows method. In the second and fourth quarter of 2005, fair value was calculated using our best available estimate of future free cash flows. No impairment resulted from this testing. During the first quarter of 2005, we impaired $34 million of goodwill and $19 million of net intangibles in The Americas segment related to our then held-for-sale subsidiary, Beanstalk. In measuring the impairment, the carrying value of these operations, including goodwill, was compared to a third-party valuation.”

Continental AG

“The annual impairment test of goodwill identified the need for an impairment write-down relating to the Electric Drives business unit (Automotive Systems division) amounting to €36.6 million as a result of the level of profitability. The goodwill amounting to €21.8 million was written down as fully impaired, and the remaining impairment of €14.8 million was allocated proportionally to the other intangible assets and property, plant, and equipment. In 2004, property, plant, and equipment amounting to €11.3 million were impaired in the Automotive Systems division due to the transfer of production and startup difficulties.
Additional impairment losses of €66.6 million were recognized for property, plant, and equipment in the Passenger and Light Truck Tires division in North America as a result of process efficiencies not yet having been achieved, as well as increased raw materials prices and the resulting poor earnings performances. In 2004, impairment write-downs of property, plant, and equipment were incurred amounting to €51.5 million. Impairment write-downs amounting to €1.3 million were recognized due to the discontinuation of passenger tire production in Hanover-Stöcken. As part of the integration of the Malaysian plants, the production of passenger and light truck tires will be limited to just one of the plants as of the second half of 2006. This led to impairment losses in the amount of €2.2 million. Impairment write-downs of property, plant, and equipment of the bias-ply tire production amounting to €1.7 million were also recognized at a plant in Malaysia.

In contrast, there were reversals of previous impairment losses on property, plant, and equipment amounting to €3.2 million for the off-the-road tire production in Bryan, Ohio, U.S.A., as the circumstances leading to the impairment were no longer prevailing.

The ContiTech division recognized impairment losses of €11.9 million in respect of property, plant, and equipment as a result of non value-creating manufacturing operations. [...].”

**GKN plc**

“In addition to impairment charges borne as a consequence of strategic reorganisation activities, a £21 million impairment charge has arisen in 2005 relating to the write-down of goodwill, property, plant and equipment at two automotive businesses where, as a consequence of current and future trading performance and projections, sufficient doubt exists over the recoverability of the assets. The impairment reviews were carried out with reference to both values in use and fair value recoverabilities. Further details regarding the goodwill impairment of £11 million is given in note 11. The remaining £10 million impairment to property, plant and equipment relates to a UK business within the Other Automotive segment where, during 2005, a decision was made to transfer certain production to a new Chinese facility. This fact and continued declining profitability has led to the significant impairment charge. In 2004, Other impairment charges were recognised in respect of the Powder Metallurgy business amounting to £162 million as a consequence of the annual impairment review. […] During the year, all goodwill was tested for impairment. An impairment test is a comparison of the carrying value of the assets of a business or cash generating unit (CGU) to their recoverable amount. Where the recoverable amount is less than the carrying value, an impairment results. Following the impairment tests, a goodwill impairment of £11 million was recognised within operating profit. This charge related to part of the Driveline business in the Asia Pacific region supplying a specific customer, where forecast performance is projected to be lower than previously expected. The pre-tax discount rate used for this CGU was 8.5%. The 2004 goodwill impairment related to the North American Powder Metallurgy business where planned recovery had been delayed by high material prices and weak markets for the business’ major customers. For the purposes of carrying out impairment tests, total Group goodwill has been allocated to a number of CGUs and each of these CGUs has been separately tested. The allocation of goodwill by business segment is set out in note 2. The size of a CGU varies but is never larger than a primary or secondary reportable segment. In many cases, the CGU is an individual subsidiary or operation. The only amount of goodwill allocated to an individual CGU which is significant
to total Group goodwill relates to goodwill, attributable to a US Aerospace business, of £78 million.

All of the recoverable amounts were measured based on value in use except for current year acquisitions, where market values have been used. Detailed forecasts for the next five years have been used in the impairment tests. These are based on approved budgets and represent a best estimate of future performance.

A number of key assumptions have been made as a basis for the impairment tests. In each case, these key assumptions have been made by management reflecting past experience and are consistent with relevant external sources of information and these are set out below. Where a reasonably possible change to an assumption would lead to an impairment, a sensitivity analysis has been provided which quantifies the amount of change required for an impairment to result. […].”

**Faurecia**

“In accordance with the accounting policy described in note 1.5, the carrying amount of each CGU – representing the lowest aggregation of assets that generate largely independent cash flows within the business segment – including goodwill allocated to that unit, has been compared with its value in use, corresponding to the present value of the future cash flows based on the most recent estimates of Group Management for each cash-generating unit concerned.

The most recent estimate used was the business plan drawn up for 2006-2009. The calculation was performed by projecting to perpetuity projected cash flows for the last year of the business plan (i.e. 2009), applying a growth rate of 1.5%. This rate, which was the same for 2005 as that for the previous year, was determined based on analysts’ forecast trends for the automotive market. Faurecia called on an independent expert to calculate the weighted average cost of capital used to discount future cash flows. The market parameters used in the expert’s calculation were based on a sample of 12 companies operating in the automotive equipment sector (six in Europe and six in the US). On the basis of these parameters and a market risk premium of 5%, the weighted average cost of capital used to discount future cash flows was set at 7.9%, unchanged from 2004.

As of December 31, 2005, the impairment test resulted in the recognition of a goodwill impairment loss in the amount of €138.4 million, relating to the Vehicle Interiors business. A further €41.6 million worth of impairment losses were recorded on other assets of this CGU, not including impairment related to restructuring. The total asset impairment figure of €180 million has been recorded under “Other operating income and expense”.

The impairment is due to a decline in operating profitability in the Vehicle Interiors business, as well as to a time lag before effects of the profitability improvement plan begin to feed through, and to the impact on forecast sales of a more selective marketing strategy. […].”

**Contingencies**

IFRS focuses on present and possible obligations resulting from past events in determining the accounting for contingent liabilities. Present obligations where an outflow of economic benefits is probable (defined as more likely than not) and reliably measurable should be accounted for as provisions. Those where the outflow is not probable but not remote should be disclosed but no liability recorded, as should possible obligations which will be confirmed by future events.
US GAAP is broadly comparable, requiring an accrual for a loss contingency if it is probable (defined as likely) that there is a present obligation resulting from a past event and an outflow of resources is probable.

Illustrative disclosures

DaimlerChrysler AG

“Contingent Obligations

Guarantees for third party liabilities principally represent guarantees of indebtedness of non-consolidated affiliated companies and third parties and commitments by Group companies as to contractual performance by joint venture companies and certain non-incorporated companies, partnerships, and project groups. The terms under these arrangements generally cover the range of the related indebtedness of the non-consolidated affiliated companies and third parties or the contractual performance period of joint venture companies, non-incorporated companies, partnerships, and project groups. The parent company of the Group (DaimlerChrysler AG) provides guarantees for certain obligations of its consolidated subsidiaries towards third parties. At December 31, 2005, these guarantees amounted to €54.0 billion. To a lesser extent, consolidated subsidiaries provide guarantees to third parties or obligations of other consolidated subsidiaries. All intercompany guarantees are eliminated in consolidation and therefore are not reflected in the above table.

DaimlerChrysler AG provides a guarantee to Deutsche Bank AG to cover the obligations of employees that are participating in its corporate credit card program for corporate travel expenses which is operated by Deutsche Bank AG. To date, DaimlerChrysler has not incurred any significant payments from that guarantee which amounted to €651 million as of December 31, 2004. In March 2005, DaimlerChrysler AG and Deutsche Bank AG concluded an additional agreement that supplements the existing framework agreement, limiting the guarantee for current and future credit card obligations arising from that program to €20 million.

Guarantees under buy-back commitments principally represent arrangements whereby the Group guarantees specified trade-in or resale values for assets or products sold to non-consolidated affiliated companies and third parties. Such guarantees provide the holder with the right to return purchased assets or products back to the Group, partially also in connection with a future purchase of products or services. [...] 

[...] Other contingent obligations principally include pledges or indemnifications related to the quality or timing of performance by third parties or participations in performance guarantees of consortiums. [...].

Commercial Commitments

In addition to the above guarantees and warranties, in connection with certain production programs, the Group has committed to purchase various levels of outsourced manufactured parts and components over extended periods at market prices. The Group has also committed to purchase or invest in the construction and maintenance of various production facilities. Amounts under these guarantees represent commitments to purchase plant or equipment at market prices in the future. As of December 31, 2005, commitments to purchase outsourced manufactured parts and components or to invest in plant and equipment are approximately €10.1 billion. [...] In addition, DaimlerChrysler also provided financial support of €13 million in Europe in 2005 to support the continuation of component deliveries, to finance specific investments and to secure launch costs. [...]

The Group also enters into non-cancellable operating leases for facilities, plant and equipment. Total rentals under operating leases charged to expense in 2005 in the statement of income amounted to €946 million (2004: 902 million; 2003: €747 million). […]"

Renault SA

“B.1. End-of-life vehicles

Under EC Directive 2000/53/EC concerning end-of-life vehicles, published in September 2000, EU member states will be obliged to take measures to ensure that: vehicles at the end of their useful life can be transferred to an approved processing centre free of charge to the last owner; specific progressive targets are met concerning the re-use rate for vehicle components, with priority given to recycling, and the value of components that can be re-used.

This Directive concerns vehicles put on the market since July 1, 2002, but will be extended to apply to all vehicles on the road by January 1, 2007. The Group establishes provisions in relation to the corresponding cost on a country-by-country basis, as the Directive is incorporated into national laws and when the procedures for recycling operations are defined. These provisions are regularly reviewed to ensure they take account of changes in each country’s situation.

For countries where the legislation is not yet complete, until the laws are in existence, it is impossible to accurately determine whether the Group will have to bear a residual cost.

B.2. Renault Argentina

Renault Argentina SA manages a savings plan called Plan Rombo SA, designed to enable savers’ groups to acquire vehicles. The savers make monthly contributions to the plan and a vehicle is delivered at the end of a given period. At December 31, 2005, Plan Rombo SA had approximately 500 savers’ groups on its books. Renault Argentina SA and Plan Rombo SA are jointly responsible to subscribers for the correct operation of the plan. Renault’s corresponding off-balance sheet commitment amounts to 105 million Argentinean pesos at December 31, 2005.

B.3. Other commitments

Disposals of subsidiaries or businesses by the Group generally include representations and warranties in the buyer’s favor. At December 31, 2005, Renault had not identified any significant risks in connection with these operations.

Following partial sales of subsidiaries during previous years, Renault retains options to sell all or a portion of its residual investment. Exercising these options would not have any significant impact on the consolidated financial statements.

Under the agreement signed in April 2003, when Renault sold a 51% stake in Renault Agriculture to Claas, Renault and Claas have options respectively to sell and purchase an additional 29% of the capital of Renault Agriculture, to be exercised within a one-year period beginning April 30, 2005, and further options respectively to sell and purchase the remaining 20%, which can be exercised from January 1, 2010.

Group companies are periodically subject to tax inspections in the countries in which they operate. Tax adjustments are recorded as provisions in the financial statements. Contested tax adjustments are recognized on a case-by-case basis, taking into account the risk that the proceedings or appeal may be unsuccessful. […]"

General Motors

“Delphi Bankruptcy

On October 8, 2005, Delphi filed a petition for Chapter 11 proceedings under the United States Bankruptcy Code
for itself and many of its US subsidiaries. Delphi is GM’s largest supplier of automotive systems, components and parts, and GM is Delphi’s largest customer.

GM will continue to work constructively in the court proceedings with Delphi, Delphi’s unions, and other participants in Delphi’s restructuring process. GM’s goal is to pursue outcomes that are in the best interests of GM and its stockholders, and that enable Delphi to continue as an important supplier to GM.

Delphi has indicated to GM that it expects no disruption in its ability to supply GM with the systems, components and parts it needs as Delphi pursues a restructuring plan under the Chapter 11 process. Although the challenges faced by Delphi during its restructuring process could create operating and financial risks for GM, that process is also expected to present opportunities for GM, but there can be no assurance that GM will be able to realize any benefits. There is a risk that Delphi or one or more of its affiliates may reject or threaten to reject individual contracts with GM, either for the purpose of exiting specific lines of business or in an attempt to increase the price GM pays for certain parts and components. As a result, GM might be materially adversely affected by disruption in the supply of automotive systems, components and parts that could force the suspension of production at GM assembly facilities.

In addition, various financial obligations Delphi has to GM as of the date of Delphi’s Chapter 11 filing, including the $951 million payable for amounts that Delphi owed to GM relating to Delphi employees who were formerly GM employees and subsequently transferred back to GM as job openings became available to them under certain employee “flowback” arrangements as of the date of Delphi’s filing for Chapter 11, may be subject to compromise in the bankruptcy proceedings, which may result in GM receiving payment of only a portion of the face amount owed by Delphi.

GM will seek to minimize this risk by protecting our right of setoff against the $1.15 billion we owed to Delphi as of the date of its Chapter 11 filing. A procedure for determining setoff claims has been put in place by the bankruptcy court. However, the extent to which these obligations are covered by our right to setoff may be subject to dispute by Delphi, the creditors committee, or Delphi’s other creditors, and limitation by the court. GM cannot provide any assurance that it will be able to fully or partially setoff such amounts. However, to date setoffs of approximately $52.5 million have been agreed to by Delphi and taken by GM.

Although GM believes that it is probable that it will be able to collect all of the amounts due from Delphi, the financial impact of a substantial compromise of our right of setoff could have a material adverse impact on our financial position. In connection with GM’s spin-off of Delphi in 1999, GM entered into separate agreements with the UAW, the International Union of Electrical Workers and the United Steel Workers. In each of these three agreements (Benefit Guarantee Agreement(s)), GM provided contingent benefit guarantees to make payments for limited pension and OPEB expenses to certain former GM US hourly employees who transferred to Delphi as part of the spin-off and meet the eligibility requirements for such payments (Covered Employees).

Each Benefit Guarantee Agreement contains separate benefit guarantees relating to pension, post-retirement health care and life insurance benefits. These limited benefit guarantees each have separate triggering events that initiate potential GM liability if Delphi fails to provide the corresponding benefit at the required level. Therefore, it is possible that GM could incur liability under one of the guarantees (e.g., pension) without triggering the other guaran-
tees (e.g., postretirement health care or life insurance). In addition, with respect to pension benefits, GM’s obligation under the pension benefit guarantees only arises to the extent that the combination of pension benefits provided by Delphi and the Pension Benefit Guaranty Corporation (PBGC) falls short of the amounts GM has guaranteed.

The Chapter 11 filing by Delphi does not by itself trigger any of the benefit guarantees. In addition, the benefit guarantees expire on October 18, 2007 if not previously triggered by Delphi’s failure to pay the specified benefits. If a benefit guarantee is triggered before its expiration date, GM’s obligation could extend for the lives of affected Covered Employees, subject to the applicable terms of the pertinent benefit plans or other relevant agreements.

The benefit guarantees do not obligate GM to guarantee any benefits for Delphi retirees in excess of the levels of corresponding benefits GM provides at any given time to GM’s own hourly retirees. Accordingly, if any of the benefits GM provides to its hourly retirees are reduced, there would be a similar reduction in GM’s obligations under the corresponding benefit guarantee.

A separate agreement between GM and Delphi requires Delphi to indemnify GM if and to the extent GM makes payments under the benefit guarantees to the UAW employees or retirees. GM received a notice from Delphi, dated October 8, 2005, that it was more likely than not that GM would become obligated to provide benefits pursuant to the benefit guarantees to the UAW employees or retirees.

The notice stated that Delphi was unable at that time to estimate the timing and scope of any benefits GM might be required to provide under those benefit guarantees. Any recovery by GM under indemnity claims against Delphi might be subject to partial or complete discharge in the Delphi reorganization proceeding. As a result, GM’s claims for indemnity may not be paid in full.

As part of the discussion to attain GM’s tentative health-care agreement with the UAW, GM provided former GM employees who became Delphi employees the potential to earn up to seven years of credited service for purposes of eligibility for certain health-care benefits under the GM/UAW benefit guarantee agreement. GM believes that it is probable that it has incurred a contingent liability due to Delphi’s Chapter 11 filing. GM believes that the range of the contingent exposures is between $5.5 billion and $12 billion, with amounts near the low end of the range considered more possible than amounts near the high end of the range assuming an agreement is reached among GM, Delphi, and Delphi’s Unions. As a result, GM established a reserve of $5.5 billion ($3.6 billion after tax) as a non-cash charge in the fourth quarter of 2005. These views reflect GM’s current assessment that it is unlikely that a Chapter 11 process will result in both a termination of Delphi’s pension plan and complete elimination of its OPEB plans.

The amount of this charge may change, depending on the result of discussions among GM, Delphi, and Delphi’s unions, and other factors. GM is currently unable to estimate the amount of additional charges, if any, which may arise from Delphi’s Chapter 11 filing. A consensual agreement to resolve the Delphi matter may cause GM to incur additional costs in exchange for benefits that would accrue to GM over time.

With respect to the possible cash flow effect on GM related to its ability to make either pension or OPEB payments, if any are required under the benefit guarantees, GM would expect to make such payments from ongoing operating cash flow and financings. Such payments, if any, are not expected to have a material effect on GM’s cash flows in the short-term. However, if payable, these payments would be likely to increase over time, and could have a material effect on GM’s liquidity in coming years. (For reference, Delphi’s 2004 Form 10-K reported that its total cash outlay
for OPEB for 2004 was $226 million, which included $154 million for both hourly and salaried retirees, the latter of whom are not covered under the benefit guarantees, plus $72 million in payments to GM for certain former Delphi hourly employees that flowed back to retire from GM). If benefits to Delphi’s US hourly employees under Delphi’s pension plan are reduced or terminated, the resulting effect on GM cash flows in future years due to the Benefit Guarantee Agreements is currently not reasonably estimable.”

Reorganisation and restructuring

Under IAS 37, a provision for some “past” costs (e.g. lease termination and redundancy) is recorded where the entity has a constructive obligation to restructure. This arises when a company has a detailed formal plan for restructuring; identifying the business concerned, the main locations and employees affected, the expenditures to be made and an expected timescale. The company should also have raised a valid expectation in those affected that the restructuring will be carried out, either by commencing implementation or by announcing its main features to those affected. Restructuring provisions should only include incremental costs not associated with ongoing or new activities of the entity (e.g. not retraining costs).

Under US GAAP, FAS 146 requires that restructuring costs be measured at fair value and prohibits the recognition of liabilities based solely on an entity’s commitment to a plan.

Illustrative disclosures

Visteon Corporation

“Restructuring: The Company defines restructuring expense to include costs directly associated with exit or disposal activities accounted for in accordance with Statement of Financial Accounting Standards No. 146 (“SFAS 146”), “Accounting for Costs Associated with Exit or Disposal Activities,” employee severance costs incurred as a result of an exit or disposal activity or a fundamental realignment accounted for in accordance with Statement of Financial Accounting Standards No. 88 (“SFAS 88”), “Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits” and Statement of Financial Accounting Standards No. 112 (“SFAS 112”), “Employers’ Accounting for Post employment Benefits” and pension and other postretirement employee benefit costs incurred as a result of an exit or disposal activity or a fundamental realignment accounted for in accordance with Statement of Financial Accounting Standard No. 87 (“SFAS 87”), “Employers’ Accounting for Pensions” and Statement of Accounting Standard No. 106 (“SFAS 106”), “Employers’ Accounting for Postretirement Benefits Other than Pensions.”

[...] 2005 Restructuring Actions

During 2005, significant restructuring activities included the following actions:

> $13 million for severance and employee related costs associated with the closure of certain North American Automotive Operations facilities located in the U.S., Mexico and Puerto Rico.

> $14 million of severance and employee related costs associated with programs offered at various Mexican and European facilities affecting approximately 700 salaried and hourly positions.
> $13 million for a pension curtailment loss related to a non-US pension plan. The curtailment loss reflects a reduction of expected future years of service for plan participants expected to transfer employment from a Company manufacturing facility to a Ford facility.

> $7 million related to the continuation of a voluntary termination incentive program offered during the fourth quarter of 2004 to eligible US salaried employees. Terms of the program required the effective termination date to be no later than March 31, 2005, unless otherwise mutually agreed.

Through March 31, 2005, 409 employees voluntarily elected to participate in this program, including 35 employees during the first quarter of 2005. As of December 31, 2005, substantially all of the employees had terminated their employment.

Previously recorded restructuring reserves of $61 million were adjusted as the Company was relieved, pursuant to the ACH Transactions, from fulfilling the remaining obligations to Ford for the transfer of seat production from the Company’s Chesterfield, Michigan operation to another supplier. […].

Lear Corporation

“Restructuring

In order to address unfavorable industry conditions, the Company began to implement consolidation and census actions in the second quarter of 2005. These actions are part of a comprehensive restructuring strategy intended to (i) better align the Company’s manufacturing capacity with the changing needs of its customers, (ii) eliminate excess capacity and lower the operating costs of the Company and (iii) streamline the Company’s organizational structure and reposition its business for improved long-term profitability. In connection with the restructuring actions, the Company expects to incur pre-tax costs of approximately $250 million, although all aspects of the restructuring actions have not been finalized. Such costs will include employee termination benefits, asset impairment charges and contract termination costs, as well as other incremental costs resulting from the restructuring actions. These incremental costs will principally include equipment and personnel relocation costs. The Company also expects to incur incremental manufacturing inefficiency costs at the operating locations impacted by the restructuring actions during the related restructuring implementation period. Restructuring costs will be recognized in the Company’s consolidated financial statements in accordance with accounting principles generally accepted in the United States. Generally, charges will be recorded as elements of the restructuring strategy are finalized. Actual costs recorded in the Company’s consolidated financial statements may vary from current estimates. In connection with the Company’s restructuring actions, the Company recorded charges of $88.9 million in 2005, including $84.6 million recorded as cost of sales and $6.2 million recorded as selling, general and administrative expenses. The remaining amounts include a gain on the sale of a facility, which is recorded as other expense, net. The 2005 charges consist of employee termination benefits of $56.5 million for 643 salaried and 3,720 hourly employees, asset impairment charges of $5.1 million and contract termination costs of $13.5 million, as well as other costs of $3.8 million. Employee termination benefits were recorded based on existing union and employee contracts, statutory requirements and completed negotiations. Asset impairment charges relate to the disposal of buildings, leasehold improvements and machinery and equipment with carrying values of $15.1 million in excess of related estimated fair values. Contract termination costs include lease cancellation costs of $3.4 million, which are expected to be paid through 2006, the repayment of vari-
ous government-sponsored grants of $4.8 million, the termination of joint venture, subcontractor and other relationships of $3.2 million and pension and other postretirement benefit plan curtailments of $2.1 million. A summary of the 2005 restructuring charges, excluding the $2.1 million pension and other postretirement benefit plan curtailments, is shown below (in millions):

<table>
<thead>
<tr>
<th>Utilization</th>
<th>Charges</th>
<th>Cash</th>
<th>Non Cash</th>
<th>Accrual as of December 31, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee termination benefits</td>
<td>$56.5</td>
<td>$(41.4)</td>
<td>—</td>
<td>$15.1</td>
</tr>
<tr>
<td>Asset impairments</td>
<td>15.1</td>
<td>—</td>
<td>(15.1)</td>
<td>—</td>
</tr>
<tr>
<td>Contract termination costs</td>
<td>11.4</td>
<td>(6.4)</td>
<td>—</td>
<td>5.0</td>
</tr>
<tr>
<td>Other related costs</td>
<td>3.8</td>
<td>(3.8)</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Total</td>
<td>$86.8</td>
<td>$(51.6)</td>
<td>(15.1)</td>
<td>$20.1</td>
</tr>
</tbody>
</table>

### Faurecia

“A provision for restructuring is booked as soon as Group General Management has decided upon a rationalization of the organization structure and announced the program to the employees concerned or their representatives. As of December 31, 2005, this item included €128.0 million worth of restructuring costs, and €12.4 million in provisions for impairment in value of assets (versus December 31, 2004: €57.1 million and €5.2 million respectively). Restructuring costs of €140.4 million and net gains arising from the streamlining of the early retirement scheme of 2.8 million, concern 2,578 employees and break down as follows by country:

<table>
<thead>
<tr>
<th>Country</th>
<th>In € million</th>
<th>Number of employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>(64.1)</td>
<td>1,063</td>
</tr>
<tr>
<td>Germany</td>
<td>(30.5)</td>
<td>689</td>
</tr>
<tr>
<td>Spain</td>
<td>(24.9)</td>
<td>245</td>
</tr>
<tr>
<td>Other</td>
<td>(18.1)</td>
<td>581</td>
</tr>
<tr>
<td>Total</td>
<td>(137.6)</td>
<td>2,578</td>
</tr>
</tbody>
</table>

### Pension and post-retirement benefits

The revised IAS 19 eliminates a number of the differences that existed previously between IAS 19 and US GAAP. However, several potentially significant differences remain that would affect comparability of financial statements prepared using IAS 19 with those prepared using US GAAP:

> **Post Employment Benefits – Definition of defined contribution plan**: If a plan does not have individual participant accounts, the plan is not a defined contribution plan for US GAAP purposes. Under IAS 19, a careful analysis of all terms and conditions of the plan, including its legal standing, must be performed to determine whether the substance of the plan is that of a defined contribution plan or defined benefit plan.

<table>
<thead>
<tr>
<th>Multiemployer</th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multi-Employer</td>
<td>Defined Benefit</td>
<td>Defined Benefit</td>
</tr>
<tr>
<td>Parent/Subsidiary under common control</td>
<td>Defined Contribution</td>
<td>Follow contractual agreement or stated policy, otherwise net defined benefit cost is recognised by sponsoring employer and contribution expense is recognised by other participating employers in their separate financial statements.</td>
</tr>
</tbody>
</table>
> Post Employment Benefits – Accounting for multiemployer and multiple-employer plans: The table below illustrates the accounting under US GAAP and IFRS for the different types of benefit arrangements.

> Post Employment Benefits – Termination indemnity benefits: Under US GAAP, EITF 88-1 provides two alternatives when accounting for the vested benefit obligation of a plan that falls within its scope: The actuarial present value of the vested benefits to which the employee is entitled if the employee separates immediately (Approach 1) – that is, the amount the company would pay out if the employee left the company as of the balance sheet date, or the actuarial present value of the vested benefits to which the employee is currently entitled but based on the employee’s expected date of separation or retirement (Approach 2).

There will be differences in the amounts recorded in the financial statements if Approach 1 is selected under US GAAP because Approach 2 is required by IAS 19.

> Post Employment Benefits – Selection of a discount rate: Although US GAAP does not explicitly address circumstances where a deep market in high-quality corporate bonds does not exist, government bonds may also be used for purposes of setting the assumed discount rate. Accordingly, if a company uses government bonds for setting its assumed discount rate under IAS 19, that methodology would also comply with US GAAP.

> Post Employment Benefits – Determination of return on plan assets: Because FAS 87 provides companies with a choice of using either a calculated value or fair value in determining the expected return on plan assets and the asset gains and losses subject to recognition, the expected return on plan assets and asset gains and losses subject to recognition will differ between IFRS and US GAAP for companies using the calculated value option.

> Post Employment Benefits – Asset ceiling test: In practice, it is expected that for pension plans in certain jurisdictions the “asset ceiling” limitation in IAS 19 will result in the recognition of a lesser pension asset under IFRS than under US GAAP.

> Post Employment Benefits – Insurance contracts as plan assets: Some contracts may meet the definition of plan assets under US GAAP but not under IFRS, particularly for groups of companies that include insurance businesses.

> Post Employment Benefits – Fair value of insurance policies: In practice, it is expected that differences will arise when determining the fair value of insurance contracts (other than annuity contracts) since under IFRS the use of the cash surrender value would generally not be appropriate.

> Post Employment Benefits – Actuarial gains and losses: Differences between IFRS and US GAAP may arise because of differing amortization periods when an entity follows the corridor approach. Additionally, there is a significant difference between the two frameworks when an entity uses the SORIE approach under IFRS, since such a treatment is not allowed under US GAAP.

> Post Employment Benefits – Recognition of vested past service cost: A difference between US GAAP and IFRS will arise from the immediate recognition of past service cost or credits under IAS 19 at the time of a plan amendment to the extent the benefits are vested. Under FAS 87 and FAS 106, those costs or credits will be recognised in the future through amortisation. Additionally, while both IAS 19 and FAS 87/FAS 106 require prior service cost for benefits not yet vested to be amortised over future periods, the amortisation periods will generally be different.
Post Employment Benefits – Recognition of negative past service cost: This difference will generally result in the recognition of a larger portion of negative past service cost in the current period for a plan accounted for under IAS 19.

Post Employment Benefits – Selecting a measurement date: Companies reporting under both IFRS and US GAAP will likely encounter differences if the measurement date for US GAAP is a date other than year-end. This is because the measurement date under IAS 19 is always the balance sheet date, whereas under FAS 87, the plan is permitted to be on a reporting lag of up to three months.

Post Employment Benefits – Minimum pension liability: It is expected that there will be differences in the amounts reported in the financial statements in situations where the accumulated benefit obligation is less than the fair value of plan assets.

Post Employment Benefits – Presentation of net pension cost: IAS 19 allows for the disaggregation of the components of net pension expense while FAS 87 does not.

Post Employment Benefits – Definition of a curtailment: Under US GAAP, a reduction in the accrual of defined benefits for future service will not meet the definition of a curtailment and, if it affects the calculation of the PBO, will be treated as a negative plan amendment. To meet the definition of a curtailment under US GAAP, the accrual of benefits for future service must be eliminated. Under IFRS, a reduction in benefits for future service will meet the definition of a curtailment.

Post Employment Benefits – Recognition criteria for curtailment gains and losses: The trigger point for recognition is different for US GAAP and IFRS. For example, a curtailment gain resulting from a reduction in workforce is recorded under IAS 19 when the entity is demonstrably committed to making a material reduction in workforce. Under FAS 88, the gain would be recorded when it is realised, which would be when the terminations have occurred. Accordingly, the gain would be recognised sooner under IAS 19 than under FAS 88. Curtailment losses due to a reduction in workforce on the other hand would likely be recorded in the same period.

Post Employment Benefits – Recognition criteria for settlement gains and losses: Under US GAAP, individual lump sum payments are settlements under FAS 88. However, settlement accounting is not applied, if under the company’s policy, the cost of all settlements in a year is less than the sum of the service cost and interest cost for the year. Under IFRS, if the settlements are due to lump sum elections by employees as part of the normal operating procedures of the plan, settlement accounting would not apply.

Post Employment Benefits – Calculation of curtailment gains and losses: The amount of curtailment gain or loss will vary between IFRS and US GAAP as a result of the different calculation methodologies. This is particularly the case because US GAAP does not permit pro rata recognition of previously unrecognised gains and losses in a curtailment while IFRS does not permit the curtailment gain or loss to be offset by previously unrecognised gains or losses unless they are “related.”

Post Employment Benefits – Calculation of settlement gains and losses: Because FAS 88 requires that the unrecognized prior service cost be excluded from the gain or loss calculation if the employees will continue to provide future service to the employer, the gain or loss reported on a plan settlement will differ between IFRS and US GAAP whenever an entity has unrecognised prior service costs.

Other Long-Term Employee Benefits – Measurement: IFRS provides specific measurement guidance and always requires discounting. FAS 112 permits, but does
not require, the use of discounting in measuring postemployment benefit obligations.

> **Other Long-Term Employee Benefits – Selection of a discount rate:** In practice, it is expected that this difference between the two frameworks could result in a significant difference in financial reporting. US GAAP’s use of a settlement rate or risk-free interest rate will generally result in a greater liability being recorded than under IFRS for other long-term employee benefits at the balance sheet date, since the settlement rate will generally be lower than high-quality corporate bond rates.

**Illustrative disclosures**

**BMW Group**

“In December 2004, the IASB issued a revised version of IAS 19, permitting actuarial gains and losses arising in conjunction with defined benefit pension obligations to be recognised directly in equity. The amount of actuarial gains and losses recognised directly in equity is shown on page 69. Under the corridor method previously used by the BMW Group, actuarial gains and losses were recognised when their net cumulative amount exceeded the higher of 10% of the present value of the obligations or 10% of the fair value of plan assets at the end of the preceding period. The amount exceeding the corridor was required to be recognised as income or expense over the average remaining working lives of the employees participating in the plans concerned. Fluctuations in the net cumulative amount of actuarial gains and losses within the corridor were not recognised on the grounds of immateriality. Unrecognised actuarial losses represented a short-fall in the amount recognised as liabilities in the balance sheet.

In accordance with the new accounting option for pension obligations, the full amount of previously unrecognised actuarial gains and losses is required to be recognised directly in equity. The revised rules do not envisage recognition through profit or loss of the amount by which actuarial gains and losses exceed the 10% corridor.

In order to improve transparency in its financial reporting, the BMW Group has elected to apply the option made available by the IASB to change the accounting treatment for pension obligations and has adopted the amendment early at 31 December 2005.

Necessary adjustments for the financial year 2004 as a result of retrospective application have an impact on periodic result, equity, pension provisions as well as deferred tax assets and liabilities.

The following components of the financial statements are affected by the change in accounting policy for defined benefit pension obligations:

> Group and sub-group Income Statement
> Group and sub-group Balance Sheets
> Group and sub-group Cash Flow Statements
> Statement of Changes in Equity - Segment Information

The restatement of the comparative figures for the financial year 2004 gives rise to an improvement in profit before tax of euro 29 million. After recognising a deferred tax expense
of euro 9 millions, the net profit for 2004 increased by euro 20 millions to euro 2,242 millions.

The adjustment to equity for periods prior to 2004 amounted to euro 751 million. Equity in the balance sheet at 31 December 2004 decreased by euro 983 million to euro 16,534 million. Pension provisions increased by euro 1,521 millions to euro 4,224 millions. Deferred tax assets increased by euro 219 million to euro 515 million, whilst deferred tax liabilities decreased by euro 319 million to euro 2,277 million.

If the Group financial statements had been prepared using the previous method, the impact would have been as follows: Profit before tax in the income statement would be euro 44 million lower. Net of a deferred tax expense of euro 16 millions, the net profit for 2005 would have been euro 28 millions lower.

In the balance sheet at 31 December 2005, equity would have been euro 1,404 million higher and pension provisions euro 2,214 million lower.

Deferred tax assets would be euro 254 millions lower and deferred tax liabilities euro 556 millions higher. […]"

**Volkswagen AG**

“An amendment to IAS 19 introduces another recognition option for actuarial gains and losses. This new option allows actuarial gains and losses to be recognized directly in equity in the period in which they occur. Volkswagen has made use of this option so that it can present information about the current level of its pension liabilities that is more decision-useful. The amounts recognized directly in equity are presented in the statement of recognized income and expense.

Recognizing actuarial gains and losses in equity rather than in profit or loss represents a change in accounting policy in accordance with IAS 8. This therefore required the restatement of actuarial gains and losses as of January 1, 2004, resulting in an increase in pension provisions by €937 million. The opening carrying amount of retained earnings was reduced by a corresponding amount, net of the related deferred tax effects. In addition, the actuarial gains and losses allocated to the income statement functions in 2004 also had to be reversed. This increased operating profit by €22 million.”

**Fiat SpA**

“There are no revised or new standards or interpretations that became effective on January 1, 2005 that had a significant effect on the Group’s financial statements.

In December 2004, the IASB issued an amendment to IAS 19 – Employee Benefits providing entities with the option of recognizing actuarial gains and losses in full in the period in which they occur, outside the income statement, in a statement of recognised income and expense. The amendment also provides guidance on allocating the cost of a group defined benefit plan to the entities in the Group. The amendment is effective for annual periods beginning on or after January 1, 2006. Management is currently evaluating the impact of this amendment.”

**Johnson Controls Inc.**

“The Company provides a range of benefits to its employees and retired employees, including pensions and post-retirement health care. Plan assets and obligations are recorded annually based on the Company’s measurement date utilizing various actuarial assumptions such as discount rates, assumed rates of return, compensation increases, turnover rates and health care cost trend rates as of that date. Measurements of net periodic benefit cost are based on the assumptions used for the previous year-end measurements of assets and obligations. The Company reviews its actuarial assumptions on an annual
basis and makes modifications to the assumptions based on current rates and trends when appropriate. As required by US GAAP, the effects of the modifications are recorded currently or amortized over future periods.

The discount rate used by the Company is based on the interest rate of noncallable high-quality corporate bonds, with appropriate consideration of the Company’s pension plans’ participants’ demographics and benefit payment terms. At July 31, 2005, the Company decreased its discount rate on US plans to 5.50 percent from 6.25 percent at July 31, 2004 (see Note 14 to the Consolidated Financial Statements). The decline of 75 basis points was consistent with the changes in published bond indices. The change increased the Company’s US projected benefit obligation at September 30, 2005 by approximately $315 million and is expected to increase pension expense in fiscal year 2006 by approximately $32 million.

In estimating the expected return on plan assets, the Company considers the historical returns on plan assets, adjusted for forward-looking considerations, inflation assumptions and the impact of the active management of the plans’ invested assets. Reflecting the relatively long-term nature of the plans’ obligations, approximately 60% of the plans’ assets were invested in equities, with the balance primarily invested in fixed income instruments.

The Company uses a market-related value of assets that recognizes the difference between the expected return and the actual return on plan assets over a three-year period. As of September 30, 2005, the Company had approximately $25 million of unrecognized asset gains associated with its US pension plans, which will be recognized in the calculation of the market-related value of assets and subject to amortization in future periods.

Based on information provided by its independent actuaries and other relevant sources, the Company believes that the assumptions used are reasonable; however, changes in these assumptions could impact the Company’s financial position, results of operations or cash flows.

Primarily as a result of a $80 million voluntary cash contribution in the current year, the Company has recorded a prepaid benefit cost of $324 million for its US pension plans as of September 30, 2005 in accordance with SFAS No. 87 “Employers’ Accounting for Pensions” (SFAS 87). SFAS 87 requires that an asset be recognized if the net periodic pension cost is less than the amounts the employer has contributed to the plan and a liability be recognized if the net periodic pension cost exceeds amounts the employer has contributed to the plan. The funded status of a retirement plan is the difference between the projected benefit obligation and the fair value of its plan assets. The projected benefit obligation is the actuarial present value of all benefits attributed by the plan’s benefit formula to employee service. At September 30, 2005, the Company’s US pension plans were under funded by $295 million since the projected benefit obligation exceeded the fair value of its plan assets. Material differences may result between the funded status of a retirement plan and the recorded asset or liability due to certain items that have an immediate impact on the projected benefit obligation, but are recognized over a longer period of time in the net periodic pension cost. For example, at September 30, 2005, the Company had an unrecognized net actuarial loss on its US pension plans of $566 million. This actuarial loss is included in the projected benefit obligation at September 30, 2005, but in accordance with SFAS 87, in general, the amount of the loss is amortized to net periodic pension expense over the average remaining service period of the employees in the plan where the loss was generated.”
Stock-based compensation

IFRS 2 requires, in particular, companies to recognise the cost of share-based awards to employees over the period from the grant date to the vesting date. The cost is assessed on a fair value basis with measurement at the grant date. Because this cannot normally be assessed directly, the fair value of the equity instruments granted should be calculated. The fair value of share awards has to be assessed using an option-pricing model. There are a number of alternatives including the Black-Scholes method, Binomial model and Monte Carlo simulations. The appropriateness depends on the complexity of the design of the share plan. IFRS 2 requires assumptions to be made including:

- Share price volatility
- Expected life of the award
- Risk free interest rate
- Future dividends
- Exercise price of the option
- Current share price of the underlying shares
- Expected forfeitures
- Allowance for meeting performance conditions

Evidence is needed to support the assumptions including a review of share price movements and historic patterns of exercise.

FAS 123R was issued in December 2004. This Statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognised over the period during which an employee is required to provide service in exchange for the award - the requisite service period (usually the vesting period). No compensation cost is recognised for equity instruments for which employees do not render the requisite service. Employee share purchase plans will not result in recognition of compensation cost if certain conditions are met; those conditions are much the same as the related conditions in Statement 123.

Illustrative disclosures

DaimlerChrysler AG

“In December 2004 the FASB issued SFAS 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”). SFAS 123R establishes the accounting for transactions in which an entity exchanges its equity instruments for goods or services. SFAS 123R also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of those equity instruments. Equity-classified awards are measured at grant date fair value and are not subsequently re-measured. Liability-classified awards are re-measured to fair value at each balance sheet date until the award is settled. SFAS 123R originally applied to all awards granted after July 1, 2005, and to awards modified, repurchased or cancelled after that date. The effective date of SFAS 123R was deferred by an SEC Rule until the beginning of the first annual period beginning after June 15, 2005. DaimlerChrysler will adopt SFAS 123R as of January 1, 2006, using a modified version of prospective application.

DaimlerChrysler expects the cumulative effect from the adoption of SFAS 123R to increase expense by €9 million in the first quarter of 2006.”

General Motors

“In December 2004, the Financial Accounting Standards Board (FASB) revised SFAS No. 123, “Accounting for Stock-Based Compensation” (SFAS 123R), requiring com-
panies to record share-based payment transactions as compensation expense at fair market value. SFAS 123R further defines the concept of fair market value as it relates to such arrangements. Based on SEC guidance issued in Staff Accounting Bulletin (SAB) 107 in April 2005, the provisions of this statement will be effective for General Motors as of January 1, 2006. The Corporation began expensing the fair market value of newly granted stock options and other stock based compensation awards to employees pursuant to SFAS 123 in 2003; therefore this statement is not expected to have a material effect on GM’s consolidated financial position or results of operations […].”

Renault SA

“Share-based payments exclusively concern stock options awarded to personnel. These generated personnel expenses of €18 million in 2005 (€11 million in 2004).

Stock option plans 1 to 9, granted between 1996 and 2003, concern share purchase options. Plans 10 and 11, granted in 2004 and 2005, concern share subscription options.

The options awarded under these plans only become vested after a period of five years for plans 1 to 8, and four years for plans 9 to 11. The exercise period then covers five years for plans 1 to 8, and four years for plans 9 to 11. Loss of the benefit of these options follows the applicable regulations: all options are forfeited in the event of resignation, and a decision is made for each individual case when an employee leaves at the company’s instigation.

The option valuation method follows a suitable binomial mathematical model, with exercise of the options anticipated and spread over the exercise period on a straight-line basis. The volatility factor applied is implicit volatility at the grant date, which represents a value coherent with market practices. The dividend used is the last known dividend at the date the plan is introduced.

In compliance with the standard’s transitional measures, only stock option plans beginning after November 7, 2002 are valued and recorded as described above.

Ford Motor Company

“We have been recording employee compensation expense in net income since January 1, 2003 under the provisions of SFAS 123, Accounting for Stock-Based Compensation. Effective December 31, 2005, we adopted the provisions of SFAS 123R, Share-Based Payment under the modified prospective method. This statement will be applied to new awards in 2006 and to any awards that are modified, repurchased, or cancelled after the date of adoption.

We continue to measure the fair value of our stock-based compensation using the Black-Scholes option-pricing model, using historical volatility and the simplified method of calculating the expected term. Our expected term is calculated by averaging the vesting term (3 years) and the contractual term of the option (10 years). Historical data is also used to estimate option exercise behaviours and employee termination experience within the valuation model. Based on our assessment of employee groupings and observable behaviours, we determined that a single grouping is appropriate. We expense compensation cost for stock options using a three year cliff vesting methodology. Shares needed for stock based compensation are issued from treasury stock. We expect to repurchase 26 million shares for treasury stock during 2006.

At December 31, 2005, Ford has outstanding a variety of stock-based compensation to employees (including Officers and members of the Board of Directors). All stock-based compensation plans are approved by the shareholders.”
Derivatives

IFRS

All derivatives are measured at fair value. To qualify for hedge accounting treatment, hedge relationships must meet certain qualifying criteria (e.g., documentation requirements and hedge effectiveness).

Gains and losses from the ineffective portion of hedges and from other derivatives are included in the income statement. The gains and losses from effective hedges are treated as follows:

> Gains and losses on fair value hedges, for both the hedging instrument and the item being hedged, are reported in the income statement.

> For cash flow hedges, including foreign currency forecasted transactions, gains and losses are initially recognised in equity and subsequently amortised to the income statement concurrent with the earnings recognition pattern of the hedged item. Gains and losses on derivatives used to hedge forecasted asset and liability acquisitions must be included in the cost of the asset or liability - so-called “basis adjustment”.

US GAAP

All derivatives must be reported on the balance sheet at fair value, regardless of any hedging relationship that may exist. As with IFRS, to qualify for hedge accounting treatment, hedge relationships need to meet certain qualifying criteria.

For cash flow hedges, including foreign currency forecasted transactions, gains and losses are initially recognised in other comprehensive income and subsequently amortised to the income statement concurrent with earnings recognition pattern of the hedged item. Gains and losses on financial instruments used to hedge forecasted asset and liability acquisition are left in other comprehensive income when the asset is acquired and subsequently amortised from there. There is no “basis adjustment” as required under IFRS.

Hedge accounting rules are comparable to those under IFRS, with the following exceptions:

> IFRS requires hedges of firm commitments to be treated as cash flow hedges whereas US GAAP considers these to be fair value hedges. US GAAP requires the commitment to be measured at fair value and recorded on the balance sheet as a “quasi - asset”. Gains and losses in the fair value of the commitment are recorded in the income statement together with gains and losses arising on the instrument hedging the commitment (which is also recorded at fair value on the balance sheet).

> If the hedged item is a financial asset or liability, it may be designated, under IFRS, as a hedged item only in relation to those risks where effectiveness can be measured. Under US GAAP, the designated risk must be the risk of changes in the overall fair value or cash flow, market interest rates, foreign currency exchange rates, or the obligor’s credit worthiness.

> If the hedged item is a non-financial asset or liability, it may be designated, under IFRS, as a hedged item only for foreign currency risk, or in its entirety because of the difficulty in isolating other risks. The guidance is similar under US GAAP, but the designated risk must hedge changes in the fair value or cash flow for the entire hedged item.

The following disclosures focus also on the hedge policy of companies regarding the changes in the international raw material markets.
Illustrative Disclosures

**Valeo SA**

“**Metal price risks**

In order to reduce its exposure to changes in prices of non-ferrous metals, the Group hedges its future purchases of base metals over a period which is generally less than 6 months. The raw materials currently hedged (aluminium, processed aluminium, copper, zinc, and tin) are quoted on official markets.

The Group favors hedging instruments which do not involve physical delivery of the underlying commodity: swaps and options on the average monthly price.

Base metals derivatives used by the Group are designated as cash flow hedges under IAS 39. An unrealized gain of 22 million euros related to hedges in place at December 31, 2005 has been recognized through Group shareholders’ equity.

The unrealized gain of 7 million euros recognized in shareholders’ equity at January 1, 2005 was in respect of hedges on raw materials purchases in first-half 2005 and was thus fully taken to operating income in the year.

The unrealized gain of 22 million euros at December 31, 2005 is broken down as follows by type of metal:

<table>
<thead>
<tr>
<th>(In millions of euros)</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aluminum</td>
<td>10</td>
</tr>
<tr>
<td>Processed aluminum</td>
<td>2</td>
</tr>
<tr>
<td>Copper</td>
<td>7</td>
</tr>
<tr>
<td>Tin</td>
<td>-</td>
</tr>
<tr>
<td>Zinc</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>22</strong></td>
</tr>
</tbody>
</table>

68% of this unrealized gain relates to purchases of raw materials denominated in euros and 29% to purchases denominated in US dollars.”

**Volkswagen AG**

“1. Hedging policy and financial derivatives

During the course of its operating and financing activities, the Volkswagen Group is exposed to fluctuations in exchange rates and interest rates. Corporate policy is to limit or eliminate such risk by means of hedging. All necessary hedging transactions are coordinated or executed centrally by Group Treasury.

2. Hedging rules

General rules apply to the Group-wide foreign currency and interest rate hedging policy; these are oriented on the “Minimum Requirements for the Performance of Trading Transactions by Credit Institutions.” Counterparties in these hedging transactions are prime-rated national and international banks, whose creditworthiness is continuously assessed by the leading rating agencies.

2.1 Foreign currency risk

Currency forwards, currency options, currency swaps and cross-currency swaps are used to limit the foreign currency risk. These transactions relate to the exchange rate hedging of all cash flows denominated in foreign currencies arising from operating activities, as well as to matching currencies for financing activities. We hedge expected foreign-currency sales revenues and materials purchases by means of forward exchange transactions and currency options, depending on the market assessment. In 2005, hedging related primarily to the US dollar, sterling, Japanese yen and Swedish krone.

2.2 Interest rate risk

Interest rate risk – i.e. possible fluctuations in the value of a financial instrument due to changes in market interest rates – primarily affects medium- and long-term fixed-interest receivables and liabilities. Interest rate swaps, cross-cur-
Currency swaps and other types of interest rate contracts are entered into to hedge against this risk, depending on market conditions. Interest rate risk is hedged by fair value and cash flow hedges using the hedging instruments described above. Intercompany financing arrangements are normally structured to match their refinancing.

### 2.3 Commodity risk

The Volkswagen Group is exposed to commodity risks relating to sharp price fluctuations and availability. It eliminates or limits these risks by entering into commodity futures transactions. Hedging relates to substantial volumes of the commodities aluminium and copper, as well as the precious metals platinum, rhodium and palladium.”

**Renault SA**

“Renault’s Purchases department hedges part of its commodity risks using financial instruments such as forward purchase contracts, purchase options and tunnel contracts. These hedges concern physical purchasing operations required by the factories, and are subject to volume and time constraints. The Group does not take any speculative positions on metals.

At December 31, 2005, outstanding commodity hedges concerned certain purchases of copper and aluminium. These transactions are not currently classified as hedges.”

**Michelin Group**

“The Group is exposed to commodity risk during the period in which price increases cannot be passed on in the sale price of manufactured products. As the Group is not normally tied under long-term commercial contracts, this knock-on effect does not in general last longer than a few months. The net position corresponds to the number of days’ sales represented by inventories and firm purchase commitments (long position), less the number of days required to pass on the price increases (short position). In order to keep earnings volatility to a minimum, hedges are put in place when all of the following conditions are met:

> The decision has been made to hedge commodity risk on a regular basis,

> An organized market exists for the relevant commodity,

> The price increase lag can be determined in a reasonably reliable and consistent manner. As at 31 December 2005 no significant commodity risk hedges were in place.”

### Segment information

The most significant differences between IAS 14 and Statement 131 are in three areas: (a) the process the standards prescribe for identifying reportable segments, (b) the different treatments the standards prescribe for vertically integrated segments, (c) the basis of accounting used for reporting segment information.

> IAS 14 requires that a company report both business segments and geographical segments. They must identify one as primary, the other secondary, and provide more comprehensive disclosure for the primary segment. The dominant source and nature of a company’s risks and returns govern the designation as primary or secondary. In contrast, Statement 131 adopts a management approach that relies on the form and content of information provided by an enterprise’s internal reporting system for identifying reportable segments.

> IAS 14 encourages disclosure of vertically integrated segments as separate segments. Statement 131 requires that they be disclosed separately if that is how the company is managed.

> IAS 14 requires that segment information be prepared in conformity with the same accounting policies used
for preparing the consolidated financial statements of the company. Statement 131 does not prescribe the accounting policies to be used and, thus, permits alternative bases of accounting for segments, as long as the basis used for reporting segment information is the same basis management uses for internal reporting purposes.

Illustrative Disclosures

Peugeot Citroën SA

“In accordance with IAS 14 - Segment Information, the Group’s primary reporting format is organized by business segment, in line with its organizational and management structure.

3.1. Business segments

The Group’s operations are organized around five main segments:

> The Automobile Division, covering the design, manufacture and sale of passenger cars and light commercial vehicles under the Peugeot and Citroën marques;

> The Automotive Equipment Division, corresponding to the Faurecia group, which specializes in the vehicle interior, automobile seating, front-end and exhaust systems businesses;

> The Transportation and Logistics Division, corresponding to the Gefco group, which specializes in logistics and vehicle and goods transportation;

> The Finance Division, corresponding to the Banque PSA Finance group, which provides retail financing to the customers of the Peugeot and Citroën marques and wholesale financing to the two marques’ dealer networks;

> Other Businesses, which include the activities of the holding company, Peugeot S.A., Peugeot Motocycles and Process Conception Ingénierie, a specialist in plant and equipment design.

[...] All intersegment balance sheet items and transactions are eliminated under the heading “Eliminations”.

All intersegment commercial transactions are carried out on an arm’s length basis on the same terms and conditions as those applicable to the supply of goods and services to third parties. [...]
3.2. Geographical segments

In the table above, sales and revenue are presented by destination of products sold and investments by geographic location of the subsidiary concerned.”

Fiat SpA

“[…] The primary reporting format is by business segment, while geographical segments represent the secondary reporting format. This decision is based on the identification of the source and nature of the Group’s risks and returns, while determine how the Group is organized and define its management structure and its internal financial reporting system.

Business segment information

The internal organisation and management structure of the Fiat Group throughout the world are based on the business segment to which entities and divisions belong. In addition, the Group has investments in holding entities and service providers whose activity is different from those of the individual businesses. The following descriptions provide additional detail of this.

The Fiat Auto Sector operates internationally with three major brands Fiat, Lancia and Alfa Romeo and manufactures and markets automobiles and commercial vehicles.

> The Maserati Sector produces and markets luxury sports cars with the brand Maserati.

> The Ferrari Sector consists of the manufacturing and marketing of luxury sports cars with the brand Ferrari and the management of the Formula One racing cars.

> The Fiat Power train Technologies (FPT) Sector manufactures car engines and transmissions (these businesses were managed by the Fiat-GM Power train joint venture until April 2005). Starting from 2006 the Sector will also include Iveco, C.R.F. and the Elasis business which manufactures engines and gear boxes.

> The Agricultural and Industrial Equipment (CNH) Sector manufactures and sells tractors and agricultural equipment under the Case IH and the New Holland brands and construction equipment under the Case and New Holland brands.

> The Iveco Sector produces and sells commercial vehicles, mainly in Europe, (under the Iveco brand), buses (under the Iveco and Iris bus brands) and special vehicles (under the Iveco, Magirus and Astra brands).

> The Components Sector (Magneti Marelli) produces and sells components for lighting systems, engine control units, suspension systems, electronic systems and exhaust systems.

> The Production System Sector (Comau) designs and produces industrial automation systems and related products for the automotive industry.

> The Metallurgical product Sector (Teksid) produces components for engines, cast-iron transmissions, and magnesium bodywork components.

> The Services Sector (Business Solutions) provides accounting and human resources services, almost all of which are supplied to other Group companies.

> The activities of the Publishing and Communications Sector (Itedi) mainly include publishing the newspaper La Stampa and selling advertising space in the print, television and internet media. […]”

BMW Group

“The activities of the BMW Group are broken down into the segments Automobiles, Motorcycles and Financial Services. The Automobiles segment develops, manufactures, assembles and sells cars and off-road vehicles, under the brands BMW, MINI and Rolls-Royce as well
as spare parts and accessories. BMW and MINI brand products are sold in Germany through branches of BMW AG and by independent, authorised dealers. Sales outside Germany are handled primarily by subsidiary companies and, in a number of markets, by independent import companies.

Rolls-Royce brand vehicles are sold in the USA via a subsidiary company and elsewhere by independent, authorised dealers. The BMW Motorcycles segment develops, manufactuàres, assembles and sells BMW brand motorcycles as well as spare parts and accessories. The Financial Services segment focuses primarily on leasing automobiles, providing loan finance for retail customers and dealers, accepting customer deposits and insurance activities. The profit before financial result of this segment includes net interest income on retail customer and dealer financing business and the result of lease business. Leased products are carried at acquisition cost less straight-line depreciation down to the imputed residual value of the vehicles. Leased products are written down to their fair value where this is lower. Segment information is provided for the regions Germany, rest of Europe, the Americas and Africa, Asia and Oceania.”

**Porsche AG**

“In accordance with IAS 14, the Group’s activities are broken down by region as the primary reporting format and by business division as the secondary reporting format. Segmentation is based on the internal reporting and organizational structure, taking account of the different risk and income structures of the various regions and divisions. The segmentation by region is based on the location of the customers. According to the different risk and income structure, the Group is divided into the regions Germany, Europe without Germany, North America, and rest of the world. Segmentation by business division shows the vehicles and financial services divisions.”

**Renault SA**

“**Primary segment reporting**

Primary segment information is disclosed for the following divisions:

> The Automobile division, comprising the production, sales, and distribution subsidiaries for passenger and light commercial vehicles, automobile service subsidiaries, and the subsidiaries in charge of cash management for these companies;

> The Sales financing division, which the Group considers as an operating activity, carries out by RCI Banque and its subsidiaries for the distribution network and final customers.

Each of these two divisions forms a coherent unit with its own specific risks and returns. […]

**Secondary segment reporting**

Secondary segment information is disclosed by geographic area. […]”

**General Motors**

“SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information,” established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. GM’s chief operating decision maker is the Chief Executive Officer. The operating segments are managed
separately because each operating segment represents a strategic business unit that offers different products and serves different markets.

GM’s Auto & Other reportable operating segment consists of GM’s four automotive regions: GM North America (GMNA), GM Europe (GME), GM Latin America/Africa/Mid-East (GMLAAM), and GM Asia Pacific (GMAP), which constitute GM Automotive (GMA); and Other. GMNA designs, manufactures, and/or markets vehicles primarily in North America under the following nameplates: Chevrolet, Pontiac, GMC, Buick, Cadillac, Saturn, and HUMMER. GME, GMLAAM, and GMAP primarily meet the demands of customers outside North America with vehicles designed, manufactured, and marketed under the following nameplates: Opel, Vauxhall, Holden, Saab, Buick, Chevrolet, GMC, Cadillac, and Daewoo. Other includes the elimination of intersegment transactions, certain non-segment specific revenues and expenditures, including legacy costs related to postretirement benefits for certain Delphi and other retirees, and certain corporate activities. GM’s FIO reportable operating segment consists of GMAC and Other Financing, which includes financing entities that are not consolidated by GMAC. GMAC provides a broad range of financial services, including consumer vehicle financing, full-service leasing and fleet leasing, dealer financing, car and truck extended service contracts, residential and commercial mortgage services, commercial and vehicle insurance, and asset-based lending.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies except that the disaggregated financial results have been prepared using a management approach, which is consistent with the basis and manner in which GM management internally disaggregates financial information for the purposes of assisting in making internal operating decisions. GM evaluates performance based on stand-alone operating segment net income and generally accounts for intersegment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices. Revenues are attributed to geographic areas based on the location of the assets producing the revenues.
## OEM Segment Information

In $ millions, except for units sold in thousands

<table>
<thead>
<tr>
<th>OEMs</th>
<th>GAAP</th>
<th>Total Assets</th>
<th>Revenue</th>
<th>Units Sold</th>
<th>Net Income/ (Loss)</th>
<th>Cap Ex</th>
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| FIAT SpA                      | IFRS |              |         |            |                    |        |
|Automobiles (Fiat Auto)        |      | 24 182       | 1 697   |            | 1 959              |        |
|Agriculture and Construction Equipment (CNH) | | 12 642 | | | 316 |
|Commercial Vehicles (Iveco)    |      | 11 747       |         |            | 550                |        |
|Ferrari and Maserati          |      | 2 256        | 11      |            | 201                |        |
|Components (Magneti Marelli)   |      | 4 993        |         |            | 388                |        |
|Production Systems (Comau)     |      | 1 947        |         |            | 47                 |        |
|Metallurgical Products (Teskid) |      | 1 283        |         |            | 56                 |        |
|Services (Business Solutions)  |      | 931          |         |            | 24                 |        |
|Publishing and Communications (Itedi) | | 492 | | | 25 |
|Fiat Powertrain Technologies   |      | 2 434        |         |            | 214                |        |
|Miscellaneous and eliminations |      | (5 285)      |         |            | 1                  |        |
|**Total FIAT SpA**             |      | 73 677       | 57 621  | 1 708      | 1 758              | 3 778  |

| Ford Motor Company            | US GAAP |              |         |            |                    |        |
|Automotive                     |      | 113 829      | 153 503 | 6 818      | 7 123              |        |
|Financial Services             |      | 162 194      | 23 586  |            | 394                |        |
|Eliminations (intersegment)    |      |              | (83)    |            |                    |        |
|**Total Ford Motor Company**   |      | 275 940      | 177 089 | 6 818      | 2 024              | 7 517  |
## OEMs | GAAP | Total Assets | Revenue | Units Sold | Net Income/(Loss) | Cap Ex |
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## Tier 1 Supplier Segment Information

In $ millions, except number of employess

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<th>Company Name</th>
<th>Fiscal Year End</th>
<th>GAAP</th>
<th>Total Assets</th>
<th>Net Assets</th>
<th>Current Assets</th>
<th>Current Liabilities</th>
<th>Working Capital</th>
<th>Revenue</th>
<th>Gross Profit</th>
<th>Net Income / (Loss)</th>
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<th>R&amp;D Spending</th>
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<td>US GAAP</td>
<td>15 627</td>
<td>73</td>
<td>8 680</td>
<td>4 811</td>
<td>3 869</td>
<td>19 723</td>
<td>4 001</td>
<td>228</td>
<td>634</td>
<td>365</td>
<td>80 000</td>
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<td>Johnson Controls Inc.</td>
<td>09/30/05</td>
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<td>16 144</td>
<td>6 058</td>
<td>7 139</td>
<td>6 841</td>
<td>298</td>
<td>27 479</td>
<td>3 482</td>
<td>909</td>
<td>664</td>
<td>817</td>
<td>114 000</td>
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<td>Lear Corporation</td>
<td>12/31/05</td>
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<td>8 288</td>
<td>1 111</td>
<td>3 846</td>
<td>4 107</td>
<td>(261)</td>
<td>17 089</td>
<td>736</td>
<td>(1 382)</td>
<td>568</td>
<td>174</td>
<td>115 113</td>
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<td>Magna International Inc.</td>
<td>12/31/05</td>
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<td>12 321</td>
<td>6 565</td>
<td>6 603</td>
<td>4 388</td>
<td>2 215</td>
<td>22 811</td>
<td>2 980</td>
<td>639</td>
<td>848</td>
<td>66</td>
<td>82 800</td>
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<tr>
<td>Michelin Group</td>
<td>12/31/05</td>
<td>IFRS</td>
<td>19 915</td>
<td>5 341</td>
<td>9 386</td>
<td>6 301</td>
<td>3 085</td>
<td>19 300</td>
<td>1 694</td>
<td>1 101</td>
<td>1 599</td>
<td>699</td>
<td>129 000</td>
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<td>12/31/05</td>
<td>IFRS</td>
<td>53 740</td>
<td>24 706</td>
<td>21 098</td>
<td>14 173</td>
<td>6 925</td>
<td>51 328</td>
<td>16 232</td>
<td>3 033</td>
<td>3 619</td>
<td>3 804</td>
<td>250 862</td>
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<td>Valeo SA</td>
<td>12/31/05</td>
<td>IFRS</td>
<td>9 539</td>
<td>2 010</td>
<td>4 529</td>
<td>4 644</td>
<td>(116)</td>
<td>12 297</td>
<td>1 965</td>
<td>182</td>
<td>730</td>
<td>818</td>
<td>70 304</td>
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<tr>
<td>Visteon Corporation</td>
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<td>6 736</td>
<td>(48)</td>
<td>3 345</td>
<td>2 959</td>
<td>386</td>
<td>16 976</td>
<td>554</td>
<td>(270)</td>
<td>613</td>
<td>804</td>
<td>49 575</td>
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<td>03/31/06</td>
<td>Local</td>
<td>27 581</td>
<td>13 694</td>
<td>4 328</td>
<td>3 791</td>
<td>537</td>
<td>13 760</td>
<td>2 097</td>
<td>478</td>
<td>1 476</td>
<td>186</td>
<td>32 977</td>
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<td>TRW Automotive Holdings Corp.</td>
<td>12/31/05</td>
<td>US GAAP</td>
<td>10 230</td>
<td>1 208</td>
<td>3 599</td>
<td>3 590</td>
<td>9</td>
<td>12 643</td>
<td>1 394</td>
<td>204</td>
<td>503</td>
<td>780</td>
<td>63 100</td>
</tr>
<tr>
<td>ZF Group</td>
<td>12/31/05</td>
<td>IFRS</td>
<td>8 529</td>
<td>2 612</td>
<td>4 465</td>
<td>2 665</td>
<td>1 800</td>
<td>13 411</td>
<td>2 502</td>
<td>306</td>
<td>650</td>
<td>681</td>
<td>53 940</td>
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</tbody>
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