

Automotive Manufacturer
Special Report

Global Automotive Industry Outlook 2009

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Related Research

- [Fitch Sees Grim 2009 Outlook for US Auto Companies \(December 2009\)](#)
- [Fitch: Negative Outlook for European Auto Manufacturers in 2009 \(December 2008\)](#)
- [Fitch: Europe's Auto Industry Faces Increased Challenges \(November 2008\)](#)
- [Fitch: European Autos - Emerging Markets Mitigate Weak Mature Markets Growth \(July 2008\)](#)
- [European Auto Industry – Do Premium Brands Have More Powerful Engines Than Volume Manufacturers? \(September 2007\)](#)

Overview

Global auto manufacturers enter 2009 in a much worse state than in 2008 and continue to face challenging prospects for the year to come. Weak GDP growth and the effects of the international financial crisis will continue to have a significant impact on the global auto industry, creating downwards pressure on carmakers' credit profiles in the short to medium term. Therefore, Fitch Ratings has a negative outlook on the sector and believes that further negative rating actions are likely in the short to medium term.

The negative outlook on the global auto industry in 2009 is also exacerbated by the extent of the uncertainties facing car manufacturers. In particular, the length and severity of the current crisis are unknown and manufacturers' responses to this crisis are not clear or entirely decided at this point.

While only the US automotive industry had a negative outlook at the start of 2008 – the outlook for Indian manufacturers' credit profiles was positive and Japanese, European, South Korean and Chinese manufacturers had a stable outlook – the outlook is now negative across the whole auto sector. The industry as a whole is facing an unprecedented combination of cyclical and structural issues which underpins Fitch's negative outlook overall.

Despite the severe and rapid deterioration of auto markets in H208, Fitch expects sales to continue falling sharply in most mature markets, including the US, western Europe and Japan, in 2009. More alarming, Fitch expects new car sales growth to slow dramatically or potentially turn negative in several emerging markets. This follows years of rapid and substantial growth in these regions, which mitigated poor growth or sales declines in mature markets. In addition, uncertain consumer reaction to oil price volatility and new and future powertrains, as well as original equipment manufacturers' (OEMs) ability to respond successfully to rapidly changing consumer preferences, create additional risk.

Limited availability of credit or more expensive borrowing conditions to finance new car purchases are additional factors which will continue to weigh on vehicle sales this year. Fitch notes also that liquidity will be of utmost importance in 2009. Potential difficulty to access the financial markets and banks to fund working capital and refinance short-term maturities will put further pressure on manufacturers in the coming year. Other issues affecting most, if not all, OEMs include the potential need to support suppliers, dealers and/or financial captives (subsidiary financial groups).

Most manufacturers have already reacted to the steep deterioration in market conditions with major production cuts, which ultimately affect operating profit and cash flow generation. Further restructuring actions are likely and will be another financial burden. Fitch expects this trend to continue in 2009: profitability and cash generation should be materially lower and financial debt and leverage will increase. Fitch expects overall financial metrics to deteriorate substantially in all regions.

In the face of falling operating margins, negative cash generation and weakening financial profiles, several auto manufacturers have called on governments for support. Financial assistance provided by the US to its domestic manufacturers has prompted other companies to request similar help in their regions. A number of European countries have already announced financial aid packages to their auto industry, in the form notably of loan guarantees, credit lines and special loans for

the financial services subsidiaries as well as various subsidies or tax incentives to boost new car sales. Such help will be vital for a few manufacturers.

Some of the critical issues in 2008, including soaring raw-material prices and brutal foreign-exchange movements, have receded recently and put less pressure on manufacturers entering 2009. However, Fitch will continue to closely monitor these issues, which may emerge again in the short to medium term.

Fitch also believes that all the issues mentioned above will reshape the industry in the short to medium term, but the extent and timing of changes to come are largely uncertain. However, past the current turmoil, which may last a few years, winners will emerge, whose main characteristics should include the ability to develop and produce a wide range of attractive vehicles for most major markets; a strong brand image; advanced technologies for environmental issues and for next-generation vehicles, including hybrid, clean diesel, electric and fuel-cell vehicles; efficient production systems and ability to reduce production costs continuously; solid links with major and successful suppliers; strong retail network in major markets; and robust financial flexibility to maintain a high level of R&D and capital investments, even in a difficult environment.

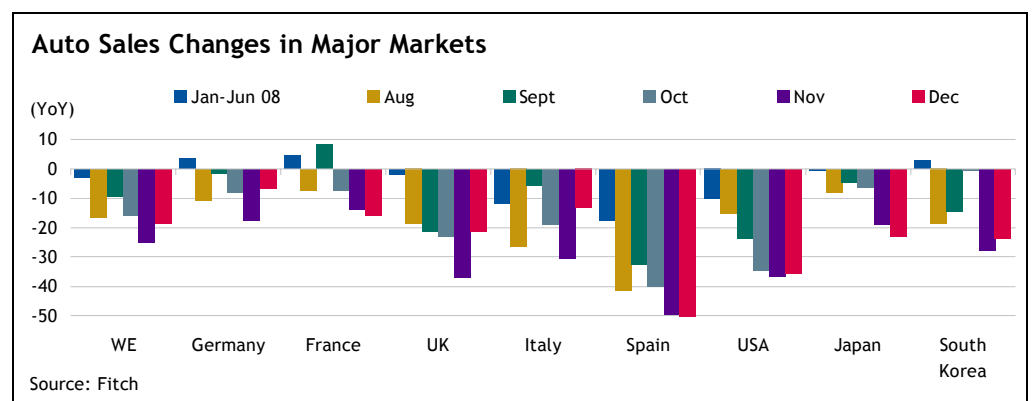
In spite of recent downgrades, Fitch expects Japanese manufacturers to remain the best-rated manufacturers. At the other end of the spectrum, US groups are still on a negative trend, all rated 'CCC' or lower. In between, in the 'BB'/'BBB' rating categories, pressure on European and South Korean groups increased in 2008 and is unlikely to abate in 2009.

Fitch-Rated Car Manufacturers

Ratings of Car Manufacturers

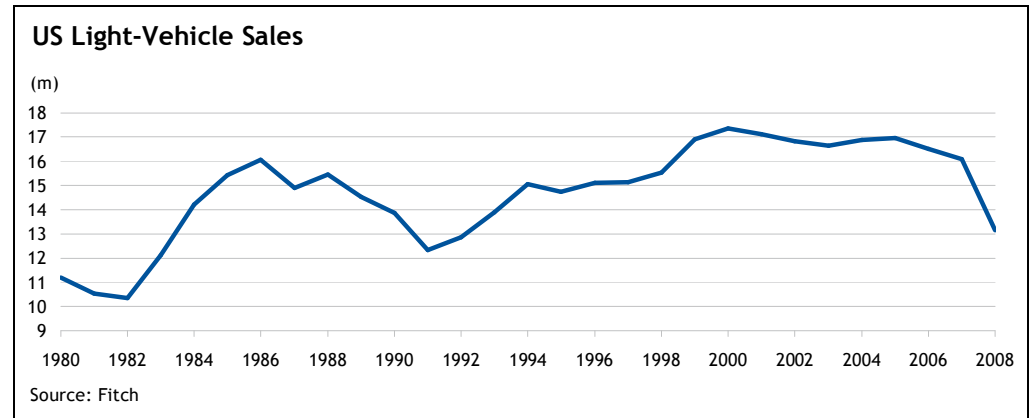
Company	Long-Term IDR	Short-Term IDR	Rating Outlook
US			
Ford Motor Company	CCC	NR	Negative
General Motors Corp.	C	NR	n.a.
Chrysler LLC	C	NR	n.a.
Europe			
Daimler AG	BBB+	F2	Stable
Fiat S.p.A.	BBB-	F3	RWN
Peugeot S.A.	BBB+	F2	Negative
Renault S.A.	BBB	NR	Negative
Volkswagen Group	BBB+	F2	RWN
Japan			
Honda Motor Co., Ltd	A	F1	Negative
Nissan Motor Co., Ltd	BBB+	F2	Negative
Toyota Motor Corporation	AA	F1+	Negative
South Korea			
Hyundai Motor Company	BB+	B	Negative
Kia Motors Corporation	BB+	B	Negative

NR = not rated; n.a. = not applicable
Source: Fitch



Negative Outlook for US Auto Manufacturers in 2009

Fitch expects the combination of a deepening US recession and the effects of the credit crisis to produce a further steep decline in 2009 automotive industry sales volumes from already-depressed 2008 levels. Fitch now projects that industry sales volumes will decline approximately 15.3% in 2009 to 11.1 million light vehicles. The first half of 2009 is expected to absorb the brunt of this decline, with a sharp decline of 30%-35% from 2008 levels, with the second half producing flat to modestly higher sales levels compared with second-half 2008 recessionary levels.



Fitch's estimate is based on the current US recession, increasing unemployment and lack of financing for retail demand. Although recent US government aid to GMAC and Chrysler Financial has moderated the rationing of credit that occurred in late 2008, tightening lending standards and lack of capital by third-party creditors will add to the pressures on financing arms and keep industry sales levels below actual demand. In the second half of 2009, steps taken by the federal government to support financial institutions and to improve market liquidity could improve retail financing availability to those consumer segments where demand exists. Fitch also expects domestic fleet sales to decline further in 2009 as a result of reduced volumes from daily rental and corporate fleets, as well as pressures on state and municipal budgets. Pickup volumes, however, could start to benefit from any material growth in infrastructure spending that may be enacted under a new stimulus package. The agency expects high unemployment and weak economic conditions to mute any material recovery in industry volumes until well into 2010, affecting US and transplant manufacturers alike.

Government Assistance

The current financial assistance package provided to General Motors (GM) and Chrysler is viewed by Fitch as a temporary measure that is likely to be materially restructured by the new administration and Congress. Both companies will need additional funding in 2009 to continue in operation, given the forecasted economic environment. Fitch expects that sufficient government aid will be forthcoming that will allow GM to continue in operation through 2009, but bankruptcy remains a distinct possibility for both companies.

Key requirements of GM's aid package have yet to be resolved, including wage and benefit levels negotiated with the United Auto Workers (UAW) union, and the restructuring of GM's unsecured debt. It is unclear how GM will complete a debt exchange without debtholders first having more clarity on the terms of any new UAW contract and the form, structure and amount of any longer-term government assistance (or lack thereof). Fitch expects that the amount and financing of the recently negotiated agreement on voluntary employees' beneficiary associations will be restructured as part of the resolution.

Bankruptcy Concerns

If GM were to file for bankruptcy, industry revenue pressures resulting from the immediate GM price discounting that would occur, as well as the resulting cost and supply issues associated with turmoil in the supplier base, could force Ford to follow at some point thereafter. In the event of a Chrysler bankruptcy, liquidation is seen as the likely outcome, with a limited impact on industry pricing. Although a Chrysler bankruptcy would have repercussions throughout the supply base and on Ford and GM's costs and production schedules, it is unlikely that a Chrysler bankruptcy would produce the same chain reaction as would a GM bankruptcy.

Fitch believes that a bankruptcy at GM would result in widespread production shutdowns across the supplier base, threatening production across the industry, including assembly operations of transplant manufacturers. At end-September 2008, GM and Ford had an estimated USD43bn in domestic, short-term trade payables, and the inability to make timely payments on any portion of these obligations would have crippling repercussions throughout the supply chain. Conversely, the inability or unwillingness of suppliers throughout the chain to supply trade credit would be the primary catalyst for a bankruptcy at one of the Detroit Three. To date, Tier-1 suppliers have managed their exposures to the Detroit Three carefully, but have shown little inclination to tighten trade terms and risk the potential snowball affect.

Auto Supplier Issues

Given the global decline in auto production forecast for 2009, the operating performance and financial condition of the auto supply industry will continue to deteriorate across the vast majority of the sector. Access to capital among the supply base is extremely limited. Even those suppliers that are more globally diversified will suffer steep revenue declines resulting from production cutbacks around the globe and currency translation. Suppliers are also becoming much more cautious in their willingness to invest in tooling and other product investment associated with new Detroit Three product opportunities. Risks among the second- and third-tier suppliers are even more acute, as these suppliers are proportionately more exposed to production cuts at the Detroit Three than more diversified top-tier suppliers, and have little or no access to external capital. The supplier industry has already seen its share of disruptive bankruptcies (Collins & Aikman, Plastech), contract disputes and other situations that have resulted in temporary production shutdowns, higher costs or various forms of financial support that ultimately accrue to the Detroit Three. Without question, these incidents will increase over the next several quarters as production ramps up from the January shutdowns and numerous smaller suppliers are unable to finance the working capital investment required. Restrictions on suppliers' ability to finance their operations through the sale of receivables of the Detroit Three have further reduced suppliers' access to external capital. Banks have been somewhat lenient in amending covenants to date, but as collateral values and borrowing bases shrink, amendments have often been accompanied by material reductions in lending commitments. Together with a move to senior secured leverage tests and covenants that often begin tightening in 2-3 quarters, senior secured lenders have heightened their asset protection and positioned themselves in the event that the company is forced to file for protection and convert to DIP financing.

Industry Future

Over the longer term, the role of the federal government in shaping the industry will be greatly enlarged. The potential for more direct governance under aid packages, when combined with regulatory and legislative initiatives, indicates that government initiatives will influence and/or define industry investment and demand over the near and long term. The range of topics that could be influenced is extensive, including fuel taxes, gas-guzzler taxes, tax credits for fuel-efficient vehicles, and federal and/or state emission standards. Ford, by positioning itself outside of the government oversight terms and structure that will be installed at

GM and Chrysler, will benefit from enhanced flexibility. Potential access to Department of Energy funding could also provide a moderate level of incremental capital to Ford as it attempts to weather weak 2009 and 2010 volumes.

The combined effects of the economic cycle and the credit crisis have also further impaired the competitive position of the Detroit Three versus the transplants. Even though transplant manufacturers are also experiencing 30%+ declines in monthly sales rates, the superior capital strength of the transplants provides a material short-term competitive advantage through their ability to access capital and offer competitive retail financing. Over the longer term, capital constraints at the Detroit Three have deferred product programmes and will continue to restrict R&D and capital investment, which will clearly impact their long-term competitive position during a period of rapid change in technology and product development. The migration of the market to smaller, more fuel-efficient vehicles is also encouraging leading European manufacturers to expand their US manufacturing and sales efforts, providing even more competition at the smaller end of the market.

In terms of product investment, there is little question that future product plans will migrate even further toward fuel-efficient, alternative-fuel and smaller vehicles. The range of technologies and product segments to be brought to market over the next five years by global manufacturers creates even more uncertainty about the ability of any individual manufacturer to establish a sustainable competitive advantage in terms of technology, product niche or margin. It remains to be seen whether the Detroit Three can achieve an adequate return on investment across the broad spectrum of vehicles in smaller car segments, given the lower price points, higher content, higher technology investment/costs, and brand weakness. Consumer demand for such vehicles, as well as their margin potential in an environment where gas prices have ranged between USD1.50 and USD4.50, remains an unknown. Although key details of Ford and GM's plans remain uncertain, including such key details as what products are going to be produced in what locations, Ford's plan appears to be an acceleration of the product strategy and restructuring plan that have been well underway. On the other hand, GM's plans regarding a substantial portion of its brand, product and manufacturing strategy appear to be still in formation. As a result, GM's plan is expected to require far more time and capital to complete than Ford's.

Summary

There are several positive factors on the horizon, but these will remain overshadowed by economic weakness and industry risks. Lower commodity prices will reduce direct material (steel, in particular) and other indirect costs, savings that will be felt more materially in the second half of 2009. Falling gas prices will also improve consumer purchasing sentiment compared with a USD4.00 gas price scenario. In addition, Fitch believes that the pickup truck market, potentially experiencing a 45%-50% peak-to-trough sales decline, could be reaching replacement demand levels. Fitch believes that pickup trucks will remain the primary driver in the ability of the Detroit Three to stabilise operating performance and cash flows. Pickup trucks are expected to remain a key 20%-25% of deliveries at Ford and GM, even following the steep decline of the last several years, with contribution margins that remain at multiples of the remainder of the companies' product line-ups. With more consolidated production in fewer plants and a reduced fixed-cost structure, any volume improvement in pickups will have a disproportionate benefit to consolidated operating performance.

Negative Outlook for European Auto Manufacturers in 2009

Fitch cautioned in its Outlook report last year that the 2008 Outlook for the auto industry was Stable in Europe but that challenges were ahead. Indeed, the environment deteriorated sharply in H208 and the improvement in European

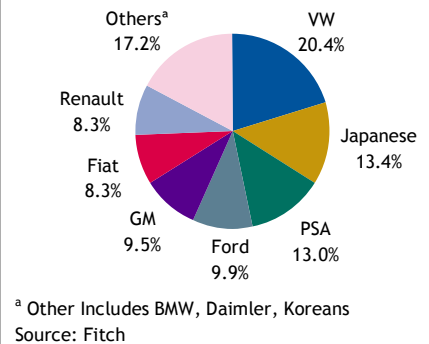
manufacturers' credit profiles in 2006-2007 came to a halt. The outlook for the credit quality of European OEMs has turned negative as the world economy enters a severe recession and global auto markets continue to decline further.

Continuous Issues in 2009

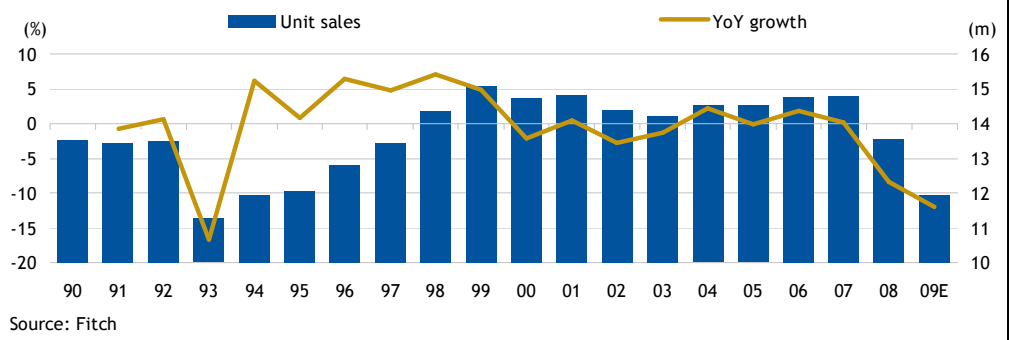
Weak GDP growth and the international financial crisis have had, and will continue to have, a significant impact on the European auto industry. In particular, Fitch expects sales in western Europe to decline by between 12%-15% in 2009 and cautions that these forecasts may be revised down further due to the ongoing deterioration of the economic environment and consumers' reaction to the weakening economy. As a result, the agency also considers a sales rebound unlikely in 2010. Emerging regions have fuelled European manufacturers' new car sales growth in recent years, but will not be as strong in the next one to two years. However, Fitch believes long-term growth prospects in emerging markets remain positive.

The negative outlook on the industry and the risk of further pressure on European carmakers' ratings also reflect the agency's assumption of a more significant downturn than the industry average in the wake of poor economic conditions. Fitch also notes that the more limited availability of credit from banks, financial institutions or the manufacturers' financial captives to finance car purchases will also have a negative impact on new car sales and compound the cyclical decline. Several additional issues will also affect some manufacturers' credit profiles, including the need for investment to comply with tighter emission legislation; increased financial support from manufacturers to ailing dealers and suppliers; and possible support for financial captives.

Breakdown of Sales Passenger Cars - WE, 2008



Car Sales in WE (Units)



Fitch expects carmakers' financial profiles to be negatively affected in 2009 by a combination of lower profitability, falling free cash flow generation and increased working capital needs. The need for cash injections to manufacturers' banks/financial services subsidiaries to protect capital adequacy ratios is also a possibility. As a result, Fitch expects financial debt to increase next year and the main credit ratios for most manufacturers to deteriorate. However, liquidity remains adequate overall. Although automotive groups have substantial refinancing needs, notably through their captives, they benefit from other sources of refinancing, outside the traditional bond market, including securitisation or repurchase agreements (repo) of eligible assets under the ECB's liquidity scheme.

A Few Positive Factors to Mitigate the Pressure

More positively, the agency notes that European automakers enter this period with stronger credit profiles than during previous downturns. All the major manufacturers have also announced additional measures to increase or accelerate cost-cutting efforts and boost efficiency. Although previous restructuring actions cannot prevent earnings declines in the wake of falling sales, this should somewhat mitigate the extent of the losses.

Furthermore, in view of the unprecedented challenges facing auto manufacturers, the industry may benefit from various forms of support from European institutions or local governments. Firstly, Fitch notes that indirect incentives or the postponement of costly legislation may be enacted. Secondly, governments from several European countries, especially those where the auto industry is crucial to the overall economy, have started to review potential financial support to OEMs and auto suppliers. Large European countries including France and Germany have announced that they are ready to provide different forms of help, such as loans or guarantees. In addition, special incentives to accelerate the renewal of older model vehicles have already been or will likely be implemented in several countries to support falling new car sales.

Negative Outlook on Most European Carmakers

Among European manufacturers rated publicly by Fitch, Peugeot SA (PSA, 'BBB+'/'F2') and Renault SA ('BBB') have a Negative Outlook, while Fiat S.p.A.'s ('BBB-'/'F3') is under Rating Watch Negative, reflecting their relative weakness in Europe and the risk of further negative rating actions should Fitch assess that new measures to offset further deterioration beyond 2009 will be insufficient. Daimler AG ('BBB+'/'F2') was downgraded from 'A-'/'F2' on 29 January 2009 as the agency reassessed its view and revised its forecasts for Daimler in 2009 and 2010 and now expects the company to exhibit much weaker profitability and cash generation than previously anticipated. The extent and rapidity of the deterioration shows Daimler's lower-than-expected resilience in a challenging economic environment. The Outlook on the Long-term IDR is Stable, reflecting the reasonable headroom within a 'BBB+' rating. Finally, while Volkswagen Group ('BBB+'/'F2') is better positioned than its European peers to face current market conditions and benefits from a strong credit profile on a standalone basis, it remains on Rating Watch Negative, reflecting the ratings risk from Porsche SE's intention to increase its stake in the company to more than 75% and put in place a domination agreement.

Negative Outlook for Japanese Auto Manufacturers in 2009

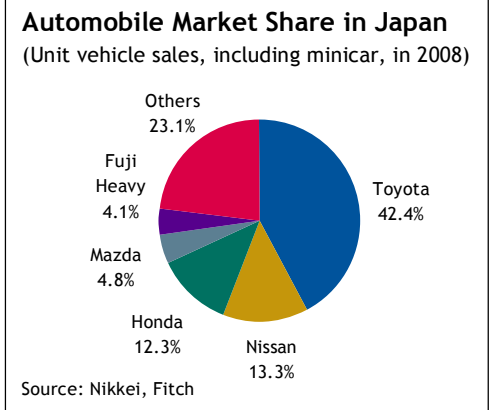
Sluggish Auto Sales

Sluggish market conditions are continuing in the Japanese market, due mainly to maturation of the market; a declining population in Japan; less interest in cars, especially among the younger generation; and weak economic conditions and concerns for the future. The average holding period of a car has been becoming longer. Unit auto sales was lowest for the past 28 years at 5.1 million vehicles (sales of new cars including mini-cars; source: Japan Auto industry associations) in 2008, a 5.1% yoy drop. The market shrank for four consecutive years and declined 35% from the peak (7.78 million units in 1990). Unit car sales excluding mini-cars were 3.2 million units, which was the lowest level for the past 34 years. There had been relatively strong demand for the mini-car segment but their unit sales also declined 2.6% in 2008 (1.9 million units).

Consumers are increasingly losing incentives to buy durable goods such as houses and autos as the recessionary economic environments likely continue. Fitch expects the sluggish market condition to continue for the coming two to three years. The Japan Automobile Manufacturers Association forecasts that unit sales of cars

including mini-vehicles will be 4.86 million units in 2009, a 4.3% decline from the 2008 figure. Fitch assumes most Japanese auto companies will make operating losses in the second half of the fiscal year ending March 2009, due to the slump of the global auto market and the significant appreciation of the yen.

Japanese auto companies are suffering from the unprecedented downturn in the global auto market. The magnitude and the duration of the very weak market conditions will likely continue longer than the agency originally expected. Fitch has recently downgraded all three rated Japanese auto companies. In line with other global manufacturers, Japanese auto makers cannot remain immune from the turmoil, particularly in view of its dependence on the significantly weakened US market on which they depend for a substantial proportion of their earnings and cash flow. In addition, extraordinary and very rapid appreciation of the yen significantly depresses the Japanese companies' earnings.



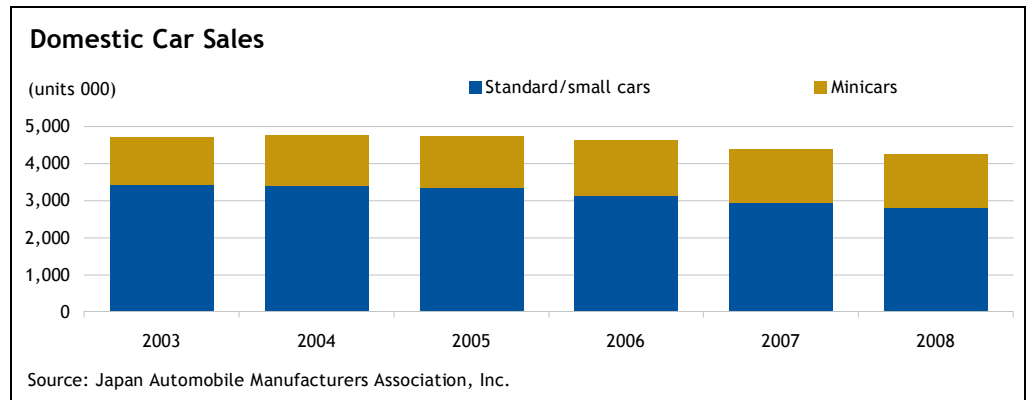
Recent Rating Actions

On 26 November 2008, Fitch downgraded Toyota Motor Corporation's (Toyota) Long-Term IDRs by two notches to 'AA'. During the past few years, Toyota has maintained an aggressive capital investment programme to enhance its overseas production capacity. As a result, the company's production capacity grew by 500,000 to 600,000 units annually. In addition, Toyota maintained its full-line strategy and tried to capture market share from the Detroit Three in the full-size pick-up truck and large SUV markets in the US, just before those markets collapsed. To address the unprecedented challenges, Fitch expects Toyota needs to review its strategic focus, product mix and speed of expansion, and will take a relatively long period of time to restructure its operations. Fitch thinks that the negative developments in the industry are so substantial and fundamental that even the strongest player, Toyota, can no longer support a 'AAA' rating.

On 21 November 2008, Fitch downgraded Nissan Motor Co., Ltd.'s (Nissan) Long-Term IDRs by one notch to 'BBB+', taking into account Nissan's historically smaller focus on compact cars than its Japanese peers, and the deteriorating credit profile of its strategic partner and major shareholder Renault SA, which Fitch also downgraded to 'BBB'/Negative from 'BBB+' /Stable on 20 November 2008.

Fitch has viewed positively Honda Motor Co., Ltd's (Honda) efficient operation, since the company focuses on fuel-efficient compact cars. In 2008, Honda's unit sales in the US market fell 8%, while GM and Toyota's unit sales declined 23% and 15%, respectively. However, this advantage is diminishing as the weak market conditions are widening into the compact car segment and emerging markets, where Honda has a good market position. On 14 January 2009, Fitch downgraded Honda's Long-Term IDR by one notch to 'A'.

The Japanese auto makers are restructuring their operations to fit the current operating environment by cutting labour forces, reducing production lines and revising their investment plans. According to Nikkei, the Japanese auto makers have already reduced output by a combined 1.2 million vehicles for the fiscal year ending March 2009, compared with their initial plans. Lower exports due to weak overseas markets and the yen's appreciation have also depressed domestic production. They are reducing production to a large extent globally and also freezing projects to raise capacity in overseas markets.



Positive Medium-Term Prospects

In Fitch's view the favourable trend for the major Japanese auto makers will continue, even with the weak economic conditions. Consumers prefer fuel-efficient compact cars even after oil prices have largely dropped from their peaks, and they will pay more attention to environmental issues as stricter environmental regulations will be implemented globally in the coming years. Fitch also expects growth in demand will come mainly from emerging markets in the long run, where the major Japanese auto makers have strengthened their positions.

Past the current turmoil, which may last a few years, winners will emerge, whose main characteristics should include the ability to develop and produce a wide range of attractive vehicles for most major markets; a strong brand image; advanced technologies for environmental issues and for next-generation vehicles, including hybrid, clean diesel, electric and fuel-cell vehicles; efficient production systems and ability to reduce production costs continuously; solid links with major and successful suppliers; strong retail network in major markets; and robust financial flexibility to maintain a high level of R&D and capital investments, even in a difficult environment.

Although Fitch has downgraded all the three major Japanese auto companies, the agency considers that they are still in a relatively good market position and have most of the features mentioned above. As a result, Fitch continues to rate them at a relatively high level in the context of the global auto sector.

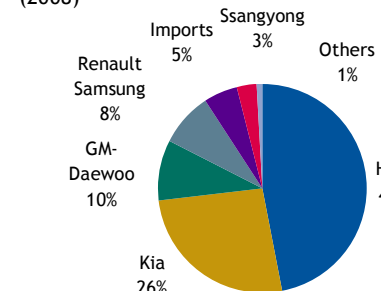
Negative Outlook for South Korean Auto Manufacturers in 2009

Fitch views the credit outlook for the South Korean auto sector to be negative, with major challenges arising from the unprecedented global economic downturn.

Global Downturn Affecting Overall Sales Across Regions

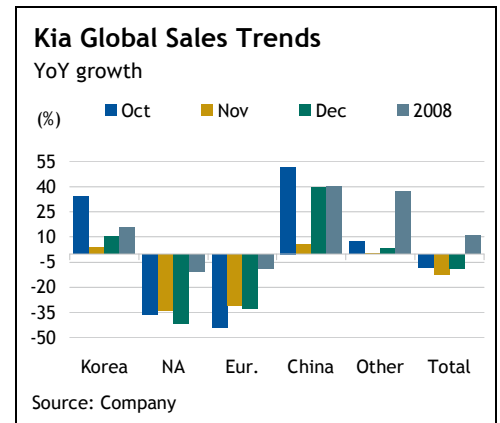
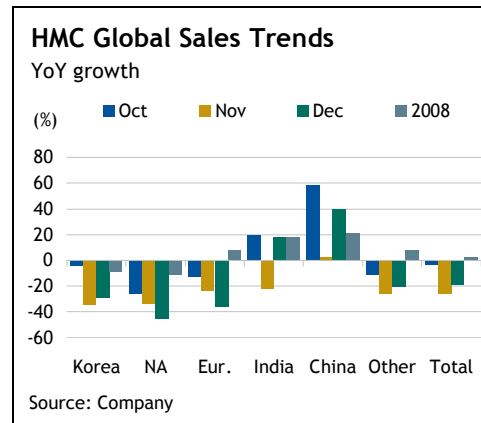
The major decline in auto demand that began in the US and Western Europe in mid 2008 is now expected to have a much wider impact globally, reflecting the global economic downturn and weak market conditions that are likely to last longer than initially expected. The major Korean automakers, Hyundai Motor Company (Hyundai) and Kia Motors Corporation (Kia), have fared better than their competitors as rising sales in emerging markets have compensated for the decline in the developed markets. However, as the economic slowdown spread into the emerging markets, auto demand in

Market Share by Company (2008)



Source: Nikkei, Fitch

these markets started to show signs of weakness in late 2008. Hyundai and Kia posted increases of 2.4% and 8.3% in 2008 global sales, respectively, but year-on-year sales growth turned negative towards Q408 (Hyundai: -16%; Kia:-8%). Reflecting the expected decline in global auto demand, Fitch expects Hyundai and Kia to post negative sales growth in 2009 as well.



Korean Market is no Exception

The Korean auto market has been no exception to the ongoing downturn in the auto industry. The sales decline accelerated during the last two months of 2008, falling by 28% and 24% yoy, respectively, which led to production cuts across the industry. Overall market volume fell 5% for the full year. The downturn has claimed the first victim in the domestic industry as Ssangyong Motors, the smallest of the five domestic automakers, filed for court receivership in January 2009. It is still unclear whether the government will provide any support to the company or its suppliers. With Fitch now expecting domestic GDP to contract 2.4% in 2009, domestic auto demand growth is likely to stay in negative territory in 2009, reflecting the economic slowdown.

Potential Labour Unrest

One recurring concern in the domestic industry is the potential labour unrest. In 2007, Hyundai's wage negotiations with the labour union ended without a strike for the first time in a decade; but 2008 was another year of labour strikes, with labour disruption affecting production and sales during Q3 for both Hyundai and Kia. Fitch notes that the labour unions of major automakers have so far been accommodating the companies' requests regarding recent production cuts and reallocation of labour force within plants. Having said that, a recent decision by the Hyundai's labour union management to begin strikes, although not yet approved by the union members, gives rise to concerns that 2009 could also see labour disruption, especially should the need for further production cuts arise with the continuing the difficult operating environment.

Recent Rating Actions

On 14 January 2009, Fitch downgraded Hyundai's and Kia's Long-Term Foreign Currency IDRs to 'BB+' from 'BBB-' and the Short-Term IDRs to 'B' from 'F3'. Simultaneously, the agency revised the Outlooks to Negative from Stable. With declining auto demand expected, as well as rises in the debt and interest burden, mostly as a result of Kia's ongoing capex, the agency considers that Hyundai's and Kia's profitability and credit metrics will deteriorate to a level no longer commensurate with investment-grade ratings.

Nevertheless, Fitch notes that Hyundai and Kia are relatively well positioned within the auto sector to weather the downturn, with a well-diversified geographical portfolio, a favourable product mix focused on fuel-efficient vehicles, and a favourable currency environment.

2009 Outlook for Indian Autos – Slowdown to Continue

The Indian auto sector (passenger vehicles) has seen one of the longest and strongest positive cycles end in September 2008, and sales growth has since faced a severe year-on-year fall. In Fitch's 2008 outlook for the sector, the agency acknowledged the inherent cyclical nature of the sector's demand pattern, wherein a three- to four- growth spurt was followed by a two-year downturn. However, Fitch's expectation for a sector recovery from mid-2008 has been delayed due to various macro-economic factors, including tight liquidity, and lower credit availability, slower GDP growth rates, and the current depressed consumer sentiment. Fitch remains cautious with regard to the demand outlook for the sector in 2009, as these key environmental factors are unlikely to improve in the near term.

Growth rates on a year-on-year basis are likely to remain depressed and even negative for a large part of 2009, partly due to the high base effect of earlier years. Fitch expects volumes to stabilise over H109, although at lower levels than in 2008. While the long-term fundamentals of the sector remain strong, the reversion to long-term growth rates of around 10%-12% CAGR for passenger vehicles is likely to require a longer and slower period of recovery than in earlier cycles. Exports are also not likely to provide the earlier cushion over 2008 due to severe slowdowns in the respective markets.

Declining Sales

Car sales have started to decline over the past few months, primarily due to increased financing costs and lack of credit availability. Domestic car sales have remained largely flat at around 1.1 million units for April-December 2008 compared with the previous period. The extent of the decline has been partly mitigated by the number of new model launches, although this has re-aligned market shares away from players with aging product portfolios. Car sales have primarily been affected by the limited availability and current high cost of consumer finance combined with lower visibility of income growth. Volumes in 2009 are likely to be supported by the large number of new launches planned by various players, although this will also intensify competition. Car makers have also been offering price reductions to stem the ongoing slowdown in sales, which could put pressure on margins. Slower demand has led to inventory pile-ups both at the dealer level and at the OEMs' own plants. However, car makers have been taking corrective measures, primarily in the form of production cuts.

Deferments in Capex to Partly Mitigate Deterioration in Credit Profiles

Most OEMs are likely to face substantial pressure on operating cash flows due to slower demand, lower margins and higher working capital requirements. This in turn will put pressure on their liquidity and credit metrics over the short to medium term. Interest coverage is likely to remain under pressure due to a combination of higher working capital utilisation, increased interest costs and Fitch's expectation of negative free cash flows for the sector. While most OEMs are implementing large-scale expansions, some of the greenfield projects are being scaled down or deferred, which could stem the extent of deterioration. That said, a material part of their expansions are non-discretionary in nature, e.g. critical capex required for new model launches and long-term strategic initiatives. Thus, while the extent of capex will remain large in relation to operating cash flows, the size of these investments is likely to be lower than that projected by Fitch in 2008. The agency consequently expects many players to report negative free cash flows through the financial year to end-March 2010 and additional pressure on operating metrics.

Negative Outlook Over the Medium Term; Long-Term Fundamentals Remain

Recovery of the sector remains contingent on improved credit availability as well as recovery of key demand drivers, including GDP growth and income visibility. The

government has recently reduced excise duties, which have already been passed on, and India's central bank, the Reserve Bank of India, has in the last three to four months undertaken several liquidity-enhancing measures and increased the availability of credit in the banking system. Fitch expects a delayed recovery for the auto sector and expects the recovery to be more likely towards the end of 2009.

Peer Group Comparison

	Toyota ^b		Honda ^b		Nissan ^b		Daimler		VW		PSA	
	FY07	FY08	FY07	FY08	FY07	FY08	2007	9M08 ^c	2007	H108 ^d	2007	H108 ^d
Auto revenues ^e	22,679	24,831	10,677	11,491	9,790	10,071	52,430	50,751	86,159	86,169	47,456	47,789
Industrial revenues ^e	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	90,688	94,574	98,752	99,872	59,069	64,702
Group revenues ^e	23,948	26,289	11,087	12,003	10,469	10,824	99,399	103,627	108,897	110,545	60,613	66,192
EBITDA margin (%)	15.1	14.3	11.0	12.3	14.8	15.0	16.7	14.3	13.5	13.9	9.0	8.2
Op margin ^a (%)	9.2	8.8	6.9	7.3	6.6	6.6	8.9	5.7	5.3	5.8	1.9	2.2
Op margin (%)	9.3	8.6	7.7	7.9	7.4	7.3	8.8	5.9	5.6	6.1	2.9	3.1
Net income margin (%)	6.9	6.5	5.3	5.0	4.4	4.5	4.9	5.3	3.8	4.3	1.5	1.6
Total debt ^a /EBITDA ^a	0.5	0.4	0.3	n.a.	0.2	0.2	0.4	0.4	0.2	0.1	1.4	1.3
Adj. debt ^a /EBITDAR ^a	0.8	0.7	1.0	n.a.	0.5	0.5	1.0	1.1	0.6	0.5	1.5	1.5
Adj. net debt ^a /EBITDAR ^a	0.2	0.1	0.2	n.a.	0.0	-0.0	-0.3	0.3	-0.7	-0.7	0.0	-0.1
CFO ^a /total debt ^a (%)	515.0	547.9	341.5	n.a.	1,004.5	-2,937.9	111.3	132.3	545.7	620.9	68.5	54.5
CFO ^a /adj. debt ^a (%)	98.4	99.1	70.0	n.a.	98.1	158.7	44.9	37.2	189.9	164.6	60.3	47.7
CFO ^a /adj. net debt ^a (%)	515.0	547.9	341.5	n.a.	1,004.5	-2,937.9	-155.8	134.3	-162.1	-115.0	3,078.9	-893.9
FCF ^a /total debt ^a (%)	56.7	39.8	20.6	n.a.	-9.4	179.9	63.5	-144.4	283.2	197.1	21.0	2.3
FCF ^a /adj. debt ^a (%)	32.3	21.2	5.7	n.a.	-3.6	75.4	25.6	-40.7	98.6	52.3	18.5	2.0
FCF ^a /adj. net debt ^a (%)	169.3	117.1	27.7	n.a.	-37.4	-1,395.0	-88.9	-146.6	-84.1	-36.5	943.0	-38.2
EBITDA ^a /interest expenses	62.2	71.0	85.0	75.3	35.7	31.4	23.7	12.7	11.2	11.4	16.4	15.8
EBITDA ^a /net interest	-37.1	-27.4	-37.3	-37.3	172.6	143.3	-37.7	-95.1	-26.6	-35.0	2,351.5	-2,379.5

^a From industrial operations

^b Financial years to end-March

^c 12 months to end-September

^d 12 months to end-June

^e USDm for Toyota, Honda, Nissan; EURm for Daimler, VW, PSA

Source: Fitch

Peer Group Comparison (cont.)

	Renault		Fiat		Hyundai ^e		Kia ^e		Ford		GM	
	2007	H108 ^b	2007	H108 ^b	2006	2007	2006	2007	2007	9M08 ^c	2007	9M08 ^c
Auto revenues ^d	38,403	37,713	31,116	33,337	45,245.4	49,474.7	14,677.5	15,045.9	154,139.0	143,280.0	178,199.0	163,525.0
Industrial revenues ^d	n.a.	n.a.	57,533	64,168	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Group revenues ^d	40,682	41,062	58,529	65,241	47,146.7	51,556.7	14,677.5	15,045.9	172,455.0	161,200.0	181,122.0	165,384.0
EBITDA margin (%)	11.1	11.5	10.1	9.6	7.5	8.1	2.5	4.0	-0.5	-3.0	-1.4	-7.2
Op margin ^a (%)	2.2	2.6	5.0	5.4	2.3	3.8	-1.8	-0.3	-2.8	-7.1	-6.0	-12.1
Op margin (%)	3.3	3.8	5.5	5.8	2.8	4.1	-1.8	-0.3	n.a.	n.a.	n.a.	n.a.
Net income margin (%)	6.6	7.2	3.3	-2.8	2.0	2.3	-1.5	-0.7	-1.8	-8.0	-21.7	-13.5
Total debt ^a /EBITDA ^a	1.9	2.2	1.1	1.5	6.9	6.7	14.1	11.8	-33.6	-6.0	-16.0	-3.7
Adj. debt ^a /EBITDAR ^a	2.6	3.0	1.3	1.5	6.9	6.7	14.1	11.8	168.4	-10.2	-27.7	-4.4
Adj. net debt ^a /EBITDAR ^a	1.2	1.7	0.2	0.4	2.0	2.3	12.0	10.3	8.1	-3.6	-11.6	-3.0
CFO ^a /total debt ^a (%)	59.9	35.7	94.4	101.6	9.9	6.6	-8.0	-10.2	32.7	-17.0	13.7	-16.9
CFO ^a /adj. debt ^a (%)	44.4	26.0	78.3	79.9	9.9	6.6	-8.0	-10.2	25.1	-13.0	11.8	-14.7
CFO ^a /adj. net debt ^a (%)	95.7	46.8	583.4	268.9	12.7	8.4	-9.4	-11.6	525.6	-36.9	28.2	-21.6
FCF ^a /total debt ^a (%)	-3.2	-29.3	29.8	3.6	-6.3	-9.6	-33.6	-32.6	10.4	-42.3	-6.2	-36.2
FCF ^a /adj. debt ^a (%)	-2.4	-21.4	24.7	2.8	-6.3	-9.6	-33.6	-32.6	8.0	-32.4	-5.4	-31.5
FCF ^a /adj. net debt ^a (%)	-5.1	-38.4	184.1	9.6	-8.1	-12.1	-39.4	-37.2	166.9	-91.7	-12.8	-46.2
EBITDA ^a /interest expenses	10.5	11.2	7.5	3.6	6.2	5.7	2.8	2.3	-0.4	-2.2	-0.9	-4.4
EBITDA ^a /net interest	39.0	31.8	13.3	5.7	18.2	12.5	3.8	3.3	n.a.	n.a.	n.a.	n.a.

^a From industrial operations

^b 12 months to end-June

^c 12 months to end-September

^d USDm for Hyundai, Kia, Ford, GM; EURm for Renault, Fiat

^e Only Op margin and Adj. net debt/EBITDAR are for industrial operations. Other ratios are consolidated.

Source: Fitch

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