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The 2012 year was predicted to show signs of an improving market for automotive sales – as year-end has approached the prediction appears to be holding true for the North American and the growing Asian markets. Europe, Japan and other developed regions have struggled as poor market conditions persisted throughout the year. There appears to be a sentiment of optimism that these markets will eventually improve or be superseded by growth in emerging and developing economies in 2013.

With increasing volumes, suppliers that have weathered the financial storm of 2008 will be poised for high growth in 2013 and beyond. The elevated growth may strain the existing capital and talent and strategies to increase productivity while developing sustainable business models may be necessary.

Technologies to improve fuel economy, emissions and recyclability will remain ongoing focal points as efficiency standards become more stringent and automakers strive to lessen the environmental impact of their vehicles. Developing innovative products and solutions to address these regulatory and OEM factors will remain important R&D investment avenues for progressive Tier I and Tier II manufacturers.

Sector economic data

Sales

Automakers reported their best sales year in a decade as Canadians bought nearly 1.68 million new vehicles in 2012, up almost six per cent for the year. The Big Three U.S. automakers accounted for about 44 per cent of the 2012 sales, down from about 47 per cent in 2011. ("Auto sales in Canada achieve best year since 2002" Waterloo Region Record, 01/04/2013)

Ford Motor Co. of Canada claimed the top sales in December, capping a third consecutive year as the best-selling automaker in the country. For the month of December, Ford's sales fell 13 per cent. Chrysler sales were up 1 per cent from December 2011 while overall sales for 2012 were up six per cent from 2011. General Motors of Canada's sales fell six per cent in 2012 and their sales for the month of December fell 20 per cent. Toyota Canada and Honda Canada sales were up 18.4 per cent and 21 per cent, respectively, for 2012. Hyundai Canada and Kia Canada continued their sales streak with increases for the month of December and 5.4 per cent and 19.5 per cent increases respectively for the year. ("Auto sales in Canada achieve best year since 2002" Waterloo Region Record, 01/04/2013; "Ford keeps top spot in Canada car sales" Reuters News, 01/03/2013)

"Auto sales outperformed the rest of the economy massively in Canada in 2012," said Douglas Porter, Bank of Montreal's deputy chief economist. He is forecasting a 1 per cent decline in 2013, but industry analyst Dennis DesRosiers is slightly more bullish. According to DesRosiers Automotive Consultants, the Canadian market "still hasn't reached its potential." "We believe that 2013 should see increased light vehicle sales, potentially surpassing the export-inflated 2002 high water mark. All that's needed is a two or three per cent increase, which could be provided by a combination of pent-up demand from the recessionary markets of 2009-11 plus regular growth in the market's absolute size." ("Auto sales in Canada achieve best year since 2002" Waterloo Region Record, 01/04/2013; "Low rates drive Canadian vehicle sales to 10-year high" Globe & Mail, 01/04/2012)

U.S. light vehicle sales rose 9 per cent in December to its highest level since 2007. Since U.S. sales hit a trough in 2009, they have rebounded by 4 million units, or 40 per cent, over three years, Ellen Hughes-Cromwick, chief economist of Ford Motor Co. told reporters and analysts. She's calling for the U.S. recovery to continue in 2013 and sales to surpass 15 million units, as are analysts, economists and other auto makers. ("Automakers close out 2012 strong as Dec. volume rises 9%..." Automotive News, 01/04/2013)

In the U.S., Ford sales rose 2 per cent for the month of December and 5% for all of 2012; Chrysler's sales rose 10% for December and 21% for 2012; and General Motors' sales rose 5% for December and 4% for 2012. Honda and Toyota sales also rose, recording sales increases of 26% and 9% respectively for December and 24% and 27%, respectively, for 2012. ("Automakers close out 2012 strong as Dec. volume rises 9%..." Automotive News, 01/04/2013)

Pent-up demand, year-end deals, low-rate financing and easing credit terms are driving the industry's sales. ("Automakers close out 2012 strong as Dec. volume rises 9%..." Automotive News, 01/04/2013)

Luxury Sales

A combination of factors is heating up luxury sales. These include baby boomers moving through their highest-earning years, the rise in the value of the Canadian dollar and aggressive moves by luxury auto makers into segments they once ignored, such as compacts and crossovers, poaching on territory once occupied by mass market companies. ("The cut-rate battle for the high-end buyer…" Globe & Mail, 12/18/2012)

Luxury sales are poised to hit their highest share yet of the Canadian market. They sat at 9.4 per cent for the year to date as of the end of November, up from 8.4 per cent at the end of 2011. While the overall market has risen 7 per cent, sales by luxury makers have jumped 11 per cent. ("The cut-rate battle for the high-end buyer…" Globe & Mail, 12/18/2012)

BMW Canada president Eduardo Villaverde said that sales here will hit a record in 2012 and place the Canadian unit among the top BMW markets around the world. Mercedes-Benz is also heading for a record year. And so is a third Germany-based company, Audi AG. ("The cut-rate battle for the high-end buyer…" Globe & Mail, 12/18/2012)

Marketplace

Market Share

Foreign car makers are picking up market share in Canada. For example, Kia's gains this year have come almost entirely at the expense of the Detroit-based car companies. General Motors is the biggest loser, with market share down nearly two full points (to 13.5 per cent from 15.3 at the same point in 2011, notes DesRosiers Automotive Consultants). Ford may be the No. 1 seller in Canada, but in the last year the company has lost nearly a full point of market share (to 16.5 per cent from 17.4). And even high-flying Chrysler Canada, with sales up a healthy 5.8 per cent on the year, has shed a little share in 2012 (to 14.5 per cent from 14.6 a year ago). Honda's market share has also risen from 6.5% to 7.6%, while Toyota's share is up to 10.6% from 9.1%. ("Kia aiming to make it a 48-month sales streak…" Globe & Mail, 12/08/2012; "Competitive Landscape – Canada – Q1 2013" BMI Industry Insights, 12/06/2012)

Table: Canada - Top 10 New Vehicle Sales (CBUs)

	10M11	10M12	% chg y-o-y	Market share %
Ford Motor	238,390	239,663	0.5	16.6
Chrysler	198,971	210,701	5.9	14.6
General Motors	206,582	194,830	-5.7	13.5
Toyota Motor	122,887	152,692	24.3	10.6
Hyundai	114,333	118,319	3.5	8.2
Honda Motor	87,213	109,276	25.3	7.6
Kia Motors	56,850	68,121	19.8	4.7
Nissan Motor	65,693	64,348	-2.0	4.5
Mazda Motor	59,149	62,857	6.3	4.4
Volkswagen	45,024	50,696	12.6	3.5

Source: DesRosiers Automotive Consultants

Industry Issues and Trends

Toyota Settlement & Fines

Toyota announced it reached a settlement valued between $1.2 and $1.4 billion to resolve hundreds of lawsuits from Toyota owners who said the value of their vehicles plunged after the recalls for unintended acceleration problems. Under the settlement Toyota will offer cash payments to people who sold vehicles or turned in leased vehicles between September 2009 and December 2010. It will also retrofit about 3.2 million vehicles with a brake override system, which ensures a stop even if the gas pedal is depressed. ("Toyota sets sales target of 9.7 million" Postmedia Breaking News, 12/28/2012)

A separate fund of $250 million will be established to compensate current owners whose vehicles are not eligible for a brake-override system. The amount consumers receive depends on the model and year of their Toyota, and the state in which the car was purchased. The settlement also provides that all 16 million current owners will be eligible for a customer care plan that will warranty certain parts that plaintiffs allege are tied to unintended acceleration for between three and 10 years. The agreement also provides $30 million in education grants to independent academic institutions to further the study of auto safety and to enhance driver education. ("Toyota Agrees to Fund a Settlement of Unintended Acceleration Cases…" Mena Report, 12/27/2012)

The case was filed in 2010 after drivers across the country began reporting Toyota vehicles suddenly and unintentionally accelerated. Toyota has long maintained that the vehicles were free from electronic flaws causing the acceleration. Neither the National Highway Traffic Safety Administration, nor NASA was able to find any defects in Toyota's source code that could cause these events. ("Toyota Agrees to Fund a Settlement of Unintended Acceleration Cases…" Mena Report, 12/27/2012)

Toyota also paid a record $17.4 million fine earlier in December for failing to quickly report floor mat problems with some of its Lexus models. That follows $48.8 million in Toyota fines in 2010. The company has instituted more careful product development and empowered regional units to deal more quickly with quality problems. Toyota recalled more than 150,000 2010 Lexus RX 350 and 2010 RX 450h models to address the problem ("Toyota hit with record $17M fine over floor mat safety defect" Postmedia Breaking News, 12/18/2012; "Toyota sets sales target of 9.7 million" Postmedia Breaking News, 12/28/2012)

The signed agreement notes "Toyota denies that it has violated the Safety Act or its implementing regulations." Under the agreement, Toyota will revise its product quality analytics and meet with the NHTSA once a month for six months to report on mat pedal entrapment issues. Toyota is still subject to potential civil and criminal liabilities, apart from the penalty for failing to report defect information in a timely manner. ("Toyota hit with record $17M fine over floor mat safety defect" Postmedia Breaking News, 12/18/2012)

Toyota will pay the fine to the U.S. Treasury in one lump sum within 30 days. The fine is the largest civil penalty ever paid to the NHTSA for violations related to a product recall. In a statement, Toyota reaffirmed it has agreed to pay the US$17.35 million without admitting to any violation. ("Toyota hit with record $17M fine over floor mat safety defect" Postmedia Breaking News, 12/18/2012)

GM's Camaro Announcement

General Motors' announced that it will move production of the next generation of the Chevy Camaro to Michigan. GM says that the move to assembly in Lansing, Mich., is for "improved production efficiencies" and lower capital costs. It's the only rear-wheel drive car built in Oshawa, and it's moving to share an assembly plant with the rear-wheel drive Cadillac CTS and ATS. ("It may only be business, but it still stings…" Toronto Star, 12/22/2012)

The CAW is more concerned that GM's commitment in this year's contract to maintain 16 per cent of its auto production in Canada expires in 2016, so the Camaro may not be replaced then by another model in Oshawa, with the potential loss of a thousand jobs. "Unless Oshawa gets a new product to replace this one, the future for Oshawa looks very bleak," said industry analyst Bill Pochiluk, president of AutomotiveCompass LLC. ("Oshawa plant at risk as GM pulls Camaro…" Globe & Mail, 12/19/2012; ("It may only be business, but it still stings…" Toronto Star, 12/22/2012)

During negotiations on a new contract this summer, GM officials provided no hint that Oshawa was in danger of losing the Camaro, CAW president Ken Lewenza said. The 100,000 Camaro models assembled annually represent about one-quarter of the output of two assembly lines in Oshawa. Eliminating that number of vehicles likely means wiping out a shift of production at the plant, he said. The impact will also be felt by suppliers whose only business is to supply parts for the Camaro, which may be forced to shut down. They pointed to a Johnson Controls Inc. plant in Whitby which makes seats for the Camaro, as being particularly vulnerable. In addition, a GM engine and transmission plant in St. Catharines supplies V6 and V8 engines for the car, so the ripples from the decision will expand beyond the Oshawa region. ("Oshawa plant at risk as GM pulls Camaro…" Globe & Mail, 12/19/2012)

The CAW has issued a statement demanding that GM replace Camaro production at Oshawa with another model to offset job losses at the plant and auto suppliers. The loss of the car will mean a production cut of between one quarter to one third of overall build at the facility. CAW President Ken Lewenza, in a statement, called GM's decision "callous and poorly thought-out". "General Motors has once again shown a complete and utter disregard for its workers and also Canadians in general, whose tax dollars kept the company out of bankruptcy," Lewenza added. ("CAW angered by GM move to end Camaro production at Oshawa" Just-Auto, 12/22/2012)

Ontario Minister of Economic Development and Innovation Brad Duguid vowed to hold GM "accountable" to fulfill its end of the bailout and restructuring bargain. "Given our partnership with GM, we expected a greater level of commitment to Ontario and to Ontario autoworkers," he stated. "We expect GM to move quickly to bring new product mandates to the facility and also stand by tis commitment to add a third shift on the Oshawa flex line, creating 900 jobs. GM has assured us that they will comply," Duguid said. "We will hold them to their word." ("Keep calm on GM…" Toronto Sun, 12/20/2012)

Finance Minister Jim Flaherty, who represents Oshawa, urged calm, saying he expects GM will bring new product lines into Oshawa to make up for the loss. Ontario Economic Development Minister Brad Duguid said the province expected a greater commitment from GM and would hold it accountable. GM said it would meet all its bailout obligations. ("The problem with government bailouts" Toronto Sun, 12/23/2012)

The abrupt announcement of moving the production of the Camaro highlights the fact that the automaker has got much work to do on the public relations front. While GM's recent move to boost production at the Oshawa plant softens the blow and overall, the move to shift Camaro production is a logical choice, the automaker could have done better with timing. ("GM signs buyback with US Treasury…" IHS Global Insight Daily Analysis, 12/20/2012)

Automaker Investments

Auto analyst Tony Faria, a professor emeritus of business at the University of Windsor, has predicted that Ontario will see nothing like the hiring and investment binge Ford Motor Co. has announced for its Michigan operations. Faria blames a labour cost gap between the CAW and UAW contracts. "It's just unfortunate – I wish Ontario would attract some (automotive) investment, but I don't think that's going to happen, he said. ("Don't expect big Ford investments here, says prof" Postmedia Breaking News, 12/31/2012)

During this year's bargaining with the CAW, Faria noted, the Detroit 3 gave ample warning that to justify new investments in Canada, CAW labour costs would need to be closer to the UAW, where new hires make $15.78 an hour rising to $19.28 by the end of the contract. Virtually all the jobs created in Michigan by Ford will be new hires. The same applies to the hiring that will happen at GM's Lansing operation when Camaro production moves from Oshawa (where CAW members make $34.33) Faria said. "It's a pure economic issue and unfortunately Ontario is losing out jobwise in that regard," he said. "One can certainly argue whether $15.78 is a reasonable rate and personally I don't think it is, it's too low. But from a business perspective, for General Motors, do you want to pay $15.78 an hour or $34.33? It's a no-brainer decision for the company." ("Don't expect big Ford investments here, says prof" Postmedia Breaking News, 12/31/2012)

CAW President Ken Lewenza disagrees; he insists "It's got nothing to do with labour rates. Labour rates account for seven per cent of the total cost of a vehicle. If it was all about labour rates, every single vehicle would be made in Bangladesh." And he said the CAWs newly negotiated rate for new hires – they start at 60 per cent, rising over 10 years to the full rate – is also comparable to the UAWs lower wage rate for new hires. ("Don't expect big Ford investments here, says prof" Postmedia Breaking News, 12/31/2012)

Industry Political, Legal and Regulatory Issues

Government Investments

Government subsidies are the main reason auto manufacturing does not move from Canada to the United States or Mexico, according to industry analysts. University of Ottawa professor Leslie Shiell and economist Robin Somerville from the Center for Spatial Economics estimate that direct government subsidies to the Canadian auto industry, not including the $14.4 billion bailout in 2009, amounted to $1.4 billion between 2004 and the end of 2011, a run rate of $200-million per year. ("Tangled web of subsidies supports auto sector…" Globe & Mail, 12/20/2012)

Ms Shiell and Mr. Somerville point out that much of this government largesse makes economic sense. The loss to Canadian GDP in the event the industry collapsed in 2009 would have been about $20-billion, $6-billion higher than the cost of the bailout. Outside of the bailout, the $200-million per year in subsidies seems less onerous because the sector contributes 12 per cent of GDP, or $152-billion a year (2011), to the domestic economy. ("Tangled web of subsidies supports auto sector…" Globe & Mail, 12/20/2012)

The emergence of Mexico as a major destination for auto sector investment will intensify pressure on the government to support the domestic industry at taxpayer expense. Since 2006, Mexico has climbed from the world's ninth largest auto producer to fourth, in large part because wages are more than 60 per cent lower than in Canada. ("Tangled web of subsidies supports auto sector…" Globe & Mail, 12/20/2012)

Globalization suggests that difficulties facing Canadian economic policy makers will only get worse. As the cost of subsidizing the domestic auto industry rises an even thornier question of overall tax fairness will emerge. According to Statistics Canada, the average hourly income for all Canadians in 2011 was $21.75. The average salary for unionized auto workers – newer workers are paid less, a major CAW concession that will have a big impact over time – is $34 an hour. ("Tangled web of subsidies supports auto sector…" Globe & Mail, 12/20/2012)

Government subsidies to the auto industry already represent a transfer of wealth – tax revenue – from lower-wage workers to higher-wage earners. As that dynamic is exacerbated over time, Canadians will be repeatedly forced to decide how much they are willing to sacrifice for this vital, yet expensive, sector of our economy. ("Tangled web of subsidies supports auto sector…" Globe & Mail, 12/20/2012)

Electric Vehicles – Chicken or Egg?

It's easy enough selling the virtues of vehicles that plug into a wall socket and run on low-emission electricity. They're generally clean, quiet, cheap to maintain, inexpensive fuel-wise and quick off the mark when it comes to performance. But range anxiety continues to be a deal breaker for many. Battery technologies are getting better, charging times are getting faster, but the fact is there aren't many places to charge an electric vehicle when it's not parked in your own driveway. More charging stations are needed, namely the 240-volt "Level 2" variety, which can cut charging times in half. However, there are too few electric vehicles driving the roads to justify the very investment that will boost confidence in and sales of electric vehicles. ("Toronto firm finds a home for electric cars" Toronto Star, 11/08/2012)

The Ontario government has announced the creation of a rebate program for homeowners and businesses looking to purchase Level 2 charging equipment, on top of the $5,000 to $8,500 rebate already offered on electric vehicle purchases. Starting January 1, a buyer of a charging station can get a rebate of up to 50 per cent of the total purchase and installation, capped at $1,000. ("Toronto firm finds a home for electric cars" Toronto Star, 11/08/2012)

However, cars with plugs accounted for just 0.27 per cent of North American sales and less in Europe. Governments and carmakers downsized forecasts for EV sales by 2015, 2020 and beyond. Plug-in hybrids appeared likely to fare far better than battery-only models. The Volt, Prius Plug-In and C-Max Energi all showed life toward the end of the year. Among pure EVs, only the Leaf sold in the thousands across North America and even it was a disappointment. ("Breakthrough year for EVs falls flat" Toronto Star, 12/29/2012)

Blame fell on the usual suspects: high purchase price and debatable lifetime savings in cash and greenhouse gas emissions, and, for pure battery power, limited range – even shorter than official test results – and long charging times. Meanwhile, the average fuel consumption of gasoline vehicles hit an all-time low, and Vancouver-based clean-tech analyst Dallas Kachan predicted in a year-end review that continuing fuel-economy improvements would hurt EVs. ("Breakthrough year for EVs falls flat" Toronto Star, 12/29/2012)

GM Stock Sale

General Motors Co. took its biggest step yet to escape the shadow of bankruptcy and a government bailout, saying it would spend $5.5 billion to buy a chunk of its stock held by the U.S. Treasury, which now plans to unwind itself from the auto maker within the next year or so. In the bailout of the automotive industry alone, the U.S. Treasury provided a total of $79.1 billion in loans to GM, GM's former financing arm Ally Financial Inc., Chrysler Group LLC and Chrysler's former lending arm Chrysler Financial. It has recovered a total of $45.6 billion. ("GM: 'Government Motors' No More" Wall Street Journal, 12/20/2012)

For GM, the Treasury's exit plan will free the company from government-imposed restrictions, such as limitations on executive pay and use of corporate jets. Company executives also hope it will enable GM to leave behind the "government motors" label that has been adopted by critics of the company and opponents of the bailout.

The transaction also holds a promise of increased autonomy in strategic matters. And the move will also provide the automaker with more room to take some unpopular decisions to bring down its cost structure which may not have been possible earlier. ("GM signs buyback with US Treasury…" IHS Global Insight Daily Analysis, 12/20/2012; "GM: 'Government Motors' No More" Wall Street Journal, 12/20/2012)

Under the terms of the deal, GM will pay $27.50 a share, representing a 7.9% premium over the stock's December 19th closing price. Investors paid $33 a share in GM's 2010 IPO after its trip through bankruptcy. The purchase will cut the Treasury's holding to 300.1 million shares from the current level of 500.1 million, and will lower its stake in GM to 19% from 26.5%. As early as January, the government plans to begin selling off its remaining shares through "various means in an orderly fashion" over the next year to 15 months. All told, the Treasury put $49.5 billion into GM. Once GM's buyback is complete, the Treasury will have recovered to date about $28.6 billion. The stock repurchase announcement sent GM shares up 6.6%. ("GM: 'Government Motors' No More" Wall Street Journal, 12/20/2012)

According to Treasury Assistant Secretary for Financial Stability Timothy Massad, "Moving to exit our investment in GM within the next 12 to 15 months is consistent with our dual goals of winding down [the Troubled Asset Relief Program] as soon as practicable and protecting taxpayer interests." ("GM: 'Government Motors' No More" Wall Street Journal, 12/20/2012)

GM's repurchase will be accretive to earnings per share, reducing the auto maker's total shares outstanding by about 11%. GM expects to take a charge of approximately $400 million in the fourth quarter, which will be treated as a special item. GM expects to finish the year with an estimated liquidity of about $38 billion. ("GM: 'Government Motors' No More" Wall Street Journal, 12/20/2012)

Political considerations are likely to keep Canada from following Washington's lead and selling its stake in General Motors, industry experts say, potentially until after the next general election, scheduled for 2015. ("Canada unlikely to sell GM stake soon, experts" Reuters News, 12/19/2012)

The poor performance of automotive stocks suggests that Canada would also face a sizable loss if it sold GM shares over the next two years, said Tony Faria, auto industry expert. “For the Canadian government, it’s going to be a political timing decision, it’s not going to be based on financial considerations,” he said. “Because whenever they sell, they are going to end up having lost some money.” (“Canada unlikely to sell GM stake soon, experts” Reuters News, 12/19/2012)

From a fiscal standpoint, there really is no particular rush. It does, to some extent, become as much a political decision as an economic decision when they think it’s time to sell,” Doug Porter, deputy chief economist at BMO Capital Markets. (“Canada unlikely to sell GM stake soon, experts” Reuters News, 12/19/2012)
