

## Autos Snapshot

### Investor Feedback on AXL

#### Trading Thoughts

- **Two of the most controversial equity stories in the US auto parts sector now appear to be American Axle (Neutral) and Magna (Overweight).** Over the past few weeks, we have debated both of these stocks heavily with investors, our credit/distressed team and various industry participants. In this note, we focus on AXL by summarizing where we sense the controversy is centered and what may be overlooked in the story (in a separate note later, we plan to provide similar investor feedback on MGA).
- **We have recently adopted a more visibly cautious view on American Axle's equity story** — not because we think a bankruptcy is imminent but because we believe the medium-term risk-reward on the equity is notably better in other levered suppliers, namely TRW and to a lesser extent at TEN (we also like CTB/GT, but more as tactical trades in H2 09). We think AXL, which we rate Neutral, could be most a double to \$7 (historical average 7x P/E on \$1 normalized EPS) if the stars are aligned, but we also see the possibility of an eventual bankruptcy or an out-of-court reorganization, which could lead to substantial equity dilution (i.e., a \$0-1 value, for example) — the current stock price coincidentally sits roughly in between these outcomes. In the following paragraphs, we discuss covenants, near-term liquidity issues, the GM variable and long-term dilution risk.

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#### US Autos

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## Cautious view on American Axle's equity story

- **Perhaps the highest frequency feedback we hear from the AXL bulls is that “they will get a covenant amendment”** given the string of amendments banks have offered thus far to other suppliers (most recently TRW). We think this overly simplifies the AXL debate — covenants are just one of three major issues that could derail the equity story, in our view, with the other two being that a) the company may simply run out of money (between its H2 09 working capital outflow or its \$107MM revolver capacity step-down in April 2010), something which most banks are likely to feel uncomfortable helping AXL with out of court; and b) the company is arguable over-levered given now structurally lower T900 volumes, which argues for some sort of debt restructuring that could be painful for existing equity.
- On AXL's covenants, we do not believe banks generally want to be seen as bankrupting auto suppliers, but at the same time, they will likely draw a line at some stage, particularly if they are concerned about adverse structural changes in the industry (i.e. lower SUV/pickup volumes) and if a first covenant trip has occurred as it has at AXL (which usually means valuable carrots, such as commitment size reduction and/or additional security, have already been used). In the case of AXL, we suspect banks may give AXL a short-term extension (not a formal covenant ratio amendment) similar to what they did at LEA, potentially setting up the company to run out of money on its own.
- **A second debate on AXL seems to be that GM will come to its rescue.** By way of background, GM did aid AXL significantly in its 2007 labor contract by agreeing to fund a sizable portion of the cost of restructuring AXL's high-cost labor force. Is it possible that GM could accelerate payment terms to AXL in H2 09 to help it get past a likely working cap crunch? – Maybe, but it is equally likely, in our view, that investors are blindly drawing too many parallels between the current situation at AXL and 2007. GM is not run by Wagoner anymore, but rather Henderson who must get sign off on major spending from the US Treasury. Our conversation with Treasury officials suggests that the Task Force is not scared of suppliers going bankrupt but simply wants to avoid uncontrolled supply chain disruptions (which argues UST would be supportive of GM providing AXL a DIP loan but perhaps nothing out of court).
- **Lastly, investors have faith that given Dauch's sizable personal equity stake in AXL, he will fight harder than other management teams might to avoid a bankruptcy to the end.** We fully agree on this point, and this is the primarily reason we do not have an Underweight rating on AXL. But avoiding a bankruptcy does not necessarily mean the equity will perform well. We note that even if AXL were to make it through 2009, it faces a pile of medium-term debt maturities that FCF is not likely to fully cover, according to our estimates, arguing for a sizable medium-term dilution risk even if bankruptcy were avoided.

## Stock Price Performance (last week) (source: Bloomberg)

- **Top Gainers:** TEN (15%), ARM (9%), AXL (8%), ALV (7%), BWA (6%), GPI (5%), TRW (5%), MGA (5%), PAG (3%), JCI (3%), GT (2%), S&P (0.5%)
- **Top Losers:** HTZ (-11%), DAN (-8%), AN (-5%), F (-4%)

## Consensus '09 EPS (last week) (source: FirstCall)

- **Top Gainers:** GT (36%), TRW (11%), PAG (3%), AXL (3%), BWA (3%)
- **Top Losers:** HTZ (-169%), BWA (-11%), ARM (-5%), MGA (-1%)

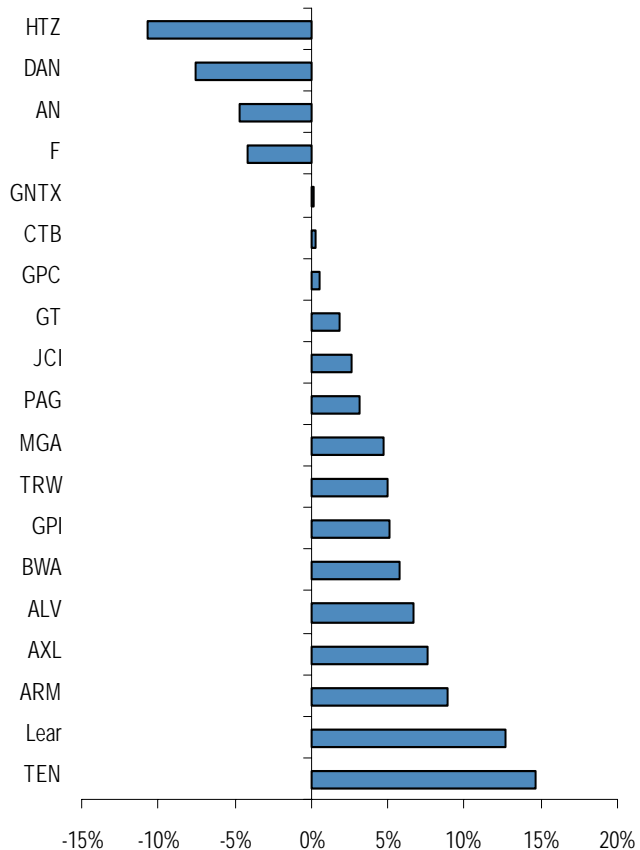
## Recent US news

- A U.S. judge approved General Motors' bankruptcy sales in a move that will allow the company's most profitable assets to exit bankruptcy protection under government ownership. (Automotive News)
- U.S. auto sales fell 27.7% y/y in June, marking the smallest drop for the industry in nine months while dashing hopes that demand would rise to a 2009 high. (Automotive News)
- Arvin Meritor announced that it has reached agreement to divest another one of its light vehicle chassis businesses, bringing the total number of units divested this year to three. (Bloomberg)
- Hyundai said it will offer U.S. buyers discounted gasoline for a year to boost sales amid sagging demand. Hyundai's "gas lock" program will let people who purchase or lease its models between July 1 and Aug. 31 pay only \$1.49 per gallon of regular grade gasoline. The price is 44 percent below the U.S. average of \$2.64 per gallon as of June 29. (Bloomberg)
- GM selling most of its assets to the U.S. government and may file for an initial public offering of its stock in 2010, according an adviser to the Obama Administration's auto task force. (Bloomberg)
- GM will pull out of auto-assembly venture with Toyota after the world's two-largest carmakers failed to agree on which vehicles to build at the plant. (Bloomberg)
- Hyundai is advancing money to U.S. dealers so they can immediately take advantage of a "cash for clunkers" program. (Bloomberg)

## Recent International News

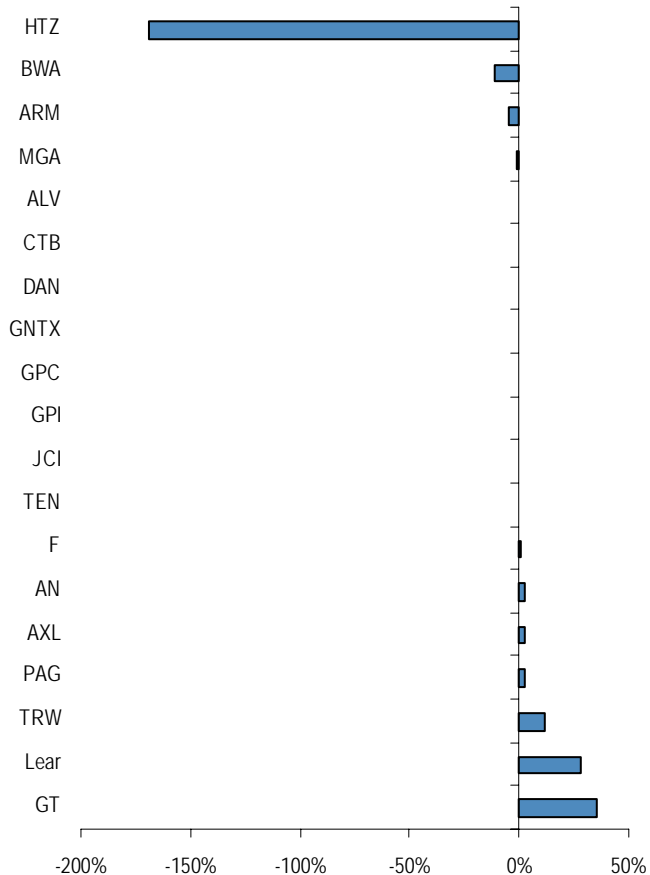
- Porsche's squabbling owners are set to discuss an investment by Qatar in the next two weeks, a milestone that could change the dynamics of a Porsche-Volkswagen merger. A successful investment from Qatar could strengthen Porsche CEO's negotiating hand as he tries to strike a deal with VW. (Automotive News)
- The German automakers association increased its forecast for 2009 new-car registrations in Germany to more than 3.5 million from more than 3.1 million previously after car sales rose 40% in June. But the association and a top executive from VW's Seat brand warned that the boom will lead to a 30% sales decline next year when scrappage incentives end. (Automotive News)
- Vehicle sales in Brazil reached a record-high of 300,174 units in June, the National Motor Vehicle Distribution Federation (Fenabrave) said. According to the report released by Fenabrave, the data is up 21.5% from May and 17.5% from the same period last year. (Bloomberg)
- Continental Tire North American Inc. has increased its ownership of Compania Ecuatoriana del Caucho S.A. (Erco) to a majority stake and plans to use the company as a base to expand its presence throughout the Andean region. (Tire Business)

Figure 1: Weekly Stock Performance: 26 June 09 through 3 July 09



Source: Bloomberg

Figure 2: Consensus 09E EPS Change: 26 June 09 through 3 July 09



Source: Bloomberg

## Valuation Tables

Table 1: Global OEMs Valuation Multiples

	Ticker	Rating	Currency	Price	Market Cap	Current EV	EV/ Sales		EV/ EBITDA		P/E	
							2009E	2010E	2009E	2010E	2009E	2010E
Ford	F US	N	\$	5.9	18,955	37,360	37%	35%	43.3x	5.3x	NA	NA
<b>US Average</b>						<b>52,183</b>	<b>37%</b>	<b>35%</b>	<b>43.3x</b>	<b>5.3x</b>	<b>NA</b>	<b>NA</b>
DAI	DAI GY	OW	€	25.0	26,503	23,446	36%	37%	11.3x	5.7x	NA	NA
BMW	BMW GY	N	€	26.6	17,395	15,599	39%	41%	5.4x	5.0x	NA	NA
VW Prefs.	VOW GY	N	€	50.0	20,025	14,842	16%	16%	1.7x	1.9x	21.3x	34.6x
PSA	UG FP	UW	€	18.1	4,225	6,957	16%	19%	3.2x	3.6x	NA	NA
Renault	RNO FP	UW	€	25.6	7,282	9,525	33%	34%	24.6x	7.8x	NA	NA
Fiat	F IM	N	€	7.2	9,202	15,996	35%	38%	5.0x	5.9x	NA	NA
Porsche	PAH3 GY	N	€	45.9	8,026	8,144	152%	123%	10.0x	7.5x	29.3x	11.4x
<b>Europe Average</b>						<b>13,501</b>	<b>47%</b>	<b>44%</b>	<b>8.7x</b>	<b>5.4x</b>	<b>25.3x</b>	<b>23.0x</b>
Toyota	7203 JP	N	¥	3610.0	12,447	11,023	64%	59%	13.7x	6.7x	NA	29.2x
Honda	7267 JP	OW	¥	2585.0	4,743	4,694	55%	49%	8.7x	5.4x	109.9x	18.4x
Nissan	7201 JP	N	¥	590.0	2,667	3,651	51%	47%	9.2x	5.3x	NA	38.0x
<b>Japan Average</b>						<b>6,456</b>	<b>56%</b>	<b>52%</b>	<b>10.5x</b>	<b>5.8x</b>	<b>109.9x</b>	<b>28.5x</b>
Hyundai	005380 KS		KW	73200.0	72500.0	15,970	13,070	46%	41%	4.7x	3.8x	14.4x
Kia	000270 KS		KW	12450.0	12700.0	4,702	9,495	59%	56%	7.6x	6.6x	13.4x
<b>S.Korea Average</b>						<b>11,282</b>	<b>53%</b>	<b>48%</b>	<b>6.2x</b>	<b>5.2x</b>	<b>13.9x</b>	<b>9.9x</b>
<b>Global Average</b>							<b>48%</b>	<b>45%</b>	<b>17.2x</b>	<b>5.4x</b>	<b>49.7x</b>	<b>20.5x</b>

Source: Company data, J.P. Morgan estimates, Bloomberg. Prices as of COB 7/3/2009

Includes Preference shares market cap as well

Note EV Calculation: Market Cap + /(-) Net Debt/(Net Cash) + Unfunded Pension and Healthcare costs + Minorities - Affiliates at Market Value- Financial Company at Book Value. Net Debt, Pension, Healthcare cost, Financial company BV and Minorities are last reported figures.

Coverage: Himanshu Patel: GM, Ford; Ranjit Unnithan: BMW, Daimler, Fiat, Porsche, VW, Renault, Peugeot; Wan Sun Park: Hyundai, Kia; Takaki Nakanishi: Toyota, Honda, Nissan.

Table 2: Global Tire Valuation Multiples

	Ticker	Rating	Currency	Price	Market Cap	Current EV	EV/ Sales		EV/ EBITDA		P/E	
							2009E	2010E	2009E	2010E	2009E	2010E
Michelin	ML FP		(€)	39.3	5,788	12,062	79%	77%	6.7x	5.4x	33.8x	13.0x
Bridgestone	5108 JP		(¥)	1574.0	1,280	2,096	79%	75%	7.8x	6.7x	233.1x	23.5x
Continental	CON GR		(€)	20.2	3,411	15,007	72%	69%	6.9x	5.6x	NA	9.7x
Goodyear	GT US	OW	(\$)	11.5	2,774	8,359	52%	50%	5.6x	4.7x	66.4x	8.8x
Cooper	CTB US	OW	(\$)	10.6	622	1,334	51%	48%	5.2x	3.8x	19.3x	8.1x
Nokian	NRE1V FH		(€)	13.8	13.4	1,668	2,085	241%	225%	11.1x	9.0x	23.0x
Hankook	000240 KS		(KW)	17650.0	16450.0	2,504	2,708	105%	101%	6.1x	5.7x	14.2x
Sumitomo	5110 JP		(¥)	785.0	206	464	89%	83%	10.4x	8.6x	NA	19.7x
Yokohama	5101 JP		(¥)	487.0	167	343	72%	69%	7.0x	6.5x	21.2x	14.3x
Kumho	073240 KS		(KW)	4835.0	4800.0	336	1,134	48%	46%	5.4x	4.2x	NA
<b>Global Average</b>							<b>89%</b>	<b>84%</b>	<b>7.2x</b>	<b>6.0x</b>	<b>58.7x</b>	<b>13.6x</b>

Source: Priced as of COB 7/3/2009

\*Market Cap & EV - ¥ and KW in billions, € and \$ in millions

Goodyear & Cooper are J.P. Morgan estimates, rest are I/B/E/S Consensus estimates.

Source: Company Data, J.P. Morgan estimates, Bloomberg

2009E, 2010E Continental nos are inclusive of VDO

Table 3: Global Auto Parts Suppliers Valuation Multiples

Ticker	Rating	Currency	Price	Market Cap	Current EV	EV/ Sales		EV/ EBITDA		P/E		
						2009E	2010E	2009E	2010E	2009E	2010E	
Autoliv	ALV US	OW	\$	28.4	2,412	3,515	83%	79%	10.0x	6.6x	NA	31.6x
American Axle	AXL US	N	\$	3.3	181	1,582	95%	77%	8.8x	5.5x	NA	NA
ArvinMeritor	ARM US	N	\$	3.9	290	2,052	40%	39%	11.6x	8.0x	NA	NA
Borg Warner	BWA US	OW	\$	32.9	3,829	4,698	122%	97%	11.8x	7.4x	80.5x	17.8x
Dana	DAN US	N	\$	1.4	140	1,136	23%	20%	4.7x	2.9x	NA	NA
Gentex	GNTX US	N	\$	10.9	1,501	1,167	256%	226%	15.5x	12.0x	57.6x	28.5x
Genuine Parts Corp.	GPC US	N	\$	33.1	5,271	5,939	59%	57%	7.3x	7.0x	14.0x	13.2x
Johnson Controls	JCI US	N	\$	20.7	12,295	17,393	59%	56%	14.2x	8.1x	78.4x	16.5x
Lear	LEA US	N	\$	0.5	0	2,544	27%	23%	12.0x	5.3x	NA	NA
Magna	MGA US	OW	\$	42.4	4,773	3,650	22%	19%	23.5x	4.2x	NA	42.3x
TRW	TRW US	OW	\$	11.6	1,174	3,916	37%	34%	7.8x	3.8x	NA	7.7x
Tenneco	TEN US	OW	\$	10.1	475	2,184	48%	41%	8.2x	5.1x	NA	50.4x
<b>US Average</b>							<b>56%</b>	<b>49%</b>	<b>10.9x</b>	<b>5.8x</b>	<b>57.6x</b>	<b>26.0x</b>
Brembo	BRE IM		€	4.2	278	547	62%	60%	5.2x	4.8x	19.4x	12.3x
Continental	CON GR		€	20.2	3,411	15,007	72%	69%	6.9x	5.6x	NA	9.7x
Faurecia	EO FP		€	6.3	564	2,235	23%	22%	7.6x	4.7x	NA	NA
GKN	GKN LN		€	121.5	857	1,716	NA	NA	NA	NA	NA	NA
Tomkins	TOMK LN		€	146.8	1,294	1,985	NA	NA	4.7x	3.9x	NA	NA
Valeo	FR FP		€	13.2	1,033	2,398	33%	32%	4.1x	3.1x	NA	101.6x
<b>Europe Average</b>							<b>48%</b>	<b>46%</b>	<b>5.7x</b>	<b>4.4x</b>	<b>19.4x</b>	<b>41.2x</b>
<b>US &amp; Europe Average</b>							<b>57%</b>	<b>56%</b>	<b>9.6x</b>	<b>5.5x</b>	<b>38.5x</b>	<b>33.6x</b>

Source: Priced as of COB 7/3/2009

\*Market Cap & EV in E millions for GKN & Tomkins, ALV, AXL, ARM, BWA, DAN, GNTX, GPC, JCI, LEA, MGA, TRW, TEN in \$ millions, rest in € millions

Beru, Brembo, Continental, Faurecia, GKN, Tomkins and Valeo are I/B/E/S Consensus estimates rest are J.P. Morgan estimates

Source: Company Data, J.P. Morgan estimates, Bloomberg

2009E, 2010E Continental nos are inclusive of VDO

Table 4: Global Auto Retailers Valuation Multiples

Ticker	Rating	Currency	Price	Market Cap	Current EV	EV/ Sales		EV/ EBITDA		P/E		
						2008	2009E	2008	2009E	2008	2009E	
AutoNation	AN US	N	\$	\$15.2	2697	5773	41%	34%	10.4x	7.7x	15.3x	14.2x
Group 1 Automotive, Inc.	GPI US	OW	\$	\$18.3	440	1805	32%	32%	14.1x	11.4x	25.7x	13.9x
Penske Automotive Group, Inc.	PAG US	OW	\$	\$11.3	1031	3590	31%	33%	11.4x	12.5x	10.5x	15.0x
Sonic Automotive	SAH US	-	\$	\$8.3	333	1998	39%	33%	13.5x	10.6x	16.8x	10.6x
CarMax	KMX US	-	\$	\$9.9	2184	2517	40%	38%	15.5x	10.4x	42.2x	20.9x
Lithia Motors	LAD US	-	\$	\$5.5	115	262	14%	13%	6.3x	5.2x	48.2x	17.6x
<b>Average</b>							<b>33%</b>	<b>31%</b>	<b>11.9x</b>	<b>9.6x</b>	<b>26.4x</b>	<b>15.3x</b>

<b>Rent- A- Car</b>												
Hertz	HTZ US		\$	\$6.3	2027	12405	146%	173%	4.1x	4.6x	15.0x	NA

Source: Priced as of COB 7/3/2009

CarMax and Lithia Motors are Bloomberg Consensus estimates rest are J.P. Morgan estimates

Source: Company Data, J.P. Morgan estimates, Bloomberg.

Debt, cash, pension are latest reported

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