IR | INDUSTRY PERSPECTIVES

Alpha IR Group

Auto & Truck Suppliers

Current Fears Appear Overdone, Making Now the Time for Proactive IR

TRADE WAR & RAW MATERIALS FEARS OVERDONE

THE U.S. AUTO CYCLE: ROOM TO RUN

COMPELLING SECTOR VALUATION

Auto & Truck Suppliers

Opportunity for Proactive IR

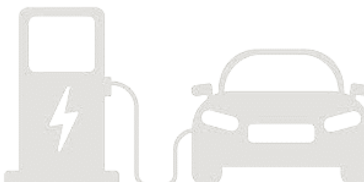
Alpha IR Group and its leaders have supported the Investor Relations efforts of public companies in every link of the auto and truck supply chain for the past 20 years. We believe the second half of 2018 and calendar 2019 will be particularly important time periods for auto supplier financial communications, as the sector has recently entered a period of perfect-storm conditions that are creating uncertainty in the marketplace. Perceived fears of an overextended U.S. auto cycle have been lingering for some time, but now investors are grappling with the impacts of strengthening commodity prices and other input cost increases, rising interest rates, tax-reform tailwinds, and foreign trade policy concerns. All of these topics are weighing heavily on the minds of investors, but many auto and truck suppliers have improved their financial positions and remain fairly attractive from a valuation standpoint. For investor relations practitioners in the industry, now is the time to be asking, "how can my company effectively navigate this complex environment and communicate the ongoing strength of our position in the U.S. auto market so that we maintain our appeal as a strong investment opportunity?"

Based on our routine buy- and sell-side discussions and formal survey work, we have identified six factors that remain critical near-term issues for the Street and require creative and strategic communication to differentiate an investment thesis within the capital markets.

1. Strong business performance and a continued healthy outlook is being drowned out by a host of worries that appear to be over-weighted relative to current valuation levels, including:

Potential Trade Wars – With tariff and trade war language dominating the financial headlines, it is important to contextualize the overall impact of the proposed tariffs relative to the larger fiscal stimulus of tax cuts and repatriation. The total tariff impact on U.S. manufactured goods is estimated to be over $80 billion. This figure is dwarfed by the estimated $800 billion benefit of lower corporate tax rates, increased capital expenditures and additional repatriation of overseas cash harbored by U.S. corporations, which suggests impacts should be manageable. ***Investors will remain laser focused on these pushes and pulls over the next year and expect proactive IR programs will offer transparency moving forward to help institutional shareholders maintain their core positions within the industry.***

Electric Vehicles – Auto manufacturers have set lofty goals for EV introductions in the coming years. However, EVs remain a fraction of new car sales in the U.S. (1.1% in 2017) and mass EV adoption has been slow (only ~800K total EV sales to date in U.S.). While traditional OEMs are beginning to accelerate investment on the EV front, the business of selling and servicing cars for the OEMs and their auto suppliers will continue to be dominated by internal combustion vehicles for the foreseeable future. While investors remain concerned about the long-term impact of EVs across the industry, they understand there is a long tail before any disruptive forces will take hold. ***That said, all supplier IR communications should be outlining how the company is taking proactive steps and investing in ways that will make the company stay relevant in tomorrow's world.***



Interest Rates – As the Federal Reserve continues to normalize interest rates and shrink its balance sheet, worries over rising rates and the potential for higher financing costs is adding to "peak demand" fears. However, employment levels and wage growth have historically been the primary factor driving auto sales, not interest rates. For now, a stronger economy, including lower unemployment levels and higher wages, are supporting the upward move in rates, albeit at a modest pace from a very low level. ***As a result, we encourage many of our clients to include historical, macro-oriented performance discussions in their communications with investors in order to highlight compelling key performance indicators that could help differentiate the story.***

Subprime – In auto credit, we have observed some volatility as a result of Fed action. Auto loan delinquency rates in the serious category (defined as 60+ days overdue) for subprime borrowers have hit 20-year highs at 5.8%. However, overall delinquency rates for auto loans in both early (30+ days overdue) or serious (60+ days overdue) delinquency combine for just 3.1% of total dollar balances, compared to the late 2008 peak of 5.6% and the 2012 lows of 2.4%. Also, car loan originations to borrowers with credit scores below 620 are roughly 20% of total originations, well below the 30% peak in 2006 and barely higher than the 2009 low of 18.5%. ***While some of the subprime auto loan data has recently turned unfavorable as delinquencies and defaults have modestly increased, we again believe the continued strength in employment and wage data outweighs these concerns and that this should be a focus in communications with the Street.***

2. Worries about the next recession and the duration of the current economic expansion obscure important indicators that ironically point toward the U.S. economy still being in the early stages of expansion.

Cyclical declines in auto sales (and auto supplier stocks) move in lockstep with cyclical declines in demand drivers (employment, confidence, income), none of which show any sign of domestic frailty. Over the last 45 years, U.S. auto cycles have grown increasingly elongated as measured in months between peak-to-peak auto sales. If the current cycle resembles most previous peak-to-peak cycles, accounting for growth in population and the economy, we derive a duration of the current cycle through 2020. Hence, the current level of U.S. light vehicle sales of ~17.0M SAAR is sustainable.

The recent drumbeat of contentious trade and tariff discussions has highlighted input cost variables and other trade-sensitive areas for these businesses. However, rather than calibrate these potential costs against a healthy demand environment and a positive mix shift, many in the investment community appear to have succumbed to the threat of the negative drumbeat. The positive, more nuanced message is a harder sell in the ninth year of an economic expansion and has seemingly gone missing.

We have advised our clients to recapture the narrative by focusing on these leading, macroeconomic indicators that continue to exhibit expansionary characteristics and sound fundamental drivers. The changes underway on Wall Street have sidelined many seasoned, tenured professionals that could normally be relied upon to push back

against the market narrative in this environment. In our mind, companies need to move proactively to fill this void through a more active and engaged IR effort that combines sophisticated targeting efforts with active outreach programs.

3. Rising raw materials prices engender investor angst, though the ultimate impact is yet to be determined.

Rising raw material costs have been a seemingly inescapable headwind for auto supplier stocks in the past few quarters. Price recovery of these cost increases will be a key performance indicator for investors and analysts going forward. The investment community has been quick to raise this issue of rising raw material costs, though volatile price performance and the threat of additional tariffs have left the ultimate bottom-line impact a moving target and thus difficult to quantify.

Communicating contract structures, price recovery lag, and other margin protection measures will remain key messaging needs in the coming quarters, as there remains a dislocation between the operational impact and the current dialogue with the Street. Additionally, the always important component of shipment mix appears to have been lost in the cacophony of trade noise. This is important as the shift toward more SUVs and light trucks provides significant headroom for automotive OEMs and their suppliers to absorb the impact of higher input costs while at the same time still experiencing a positive boost to margins. ***Corporate IROs should embrace the opportunity to provide context and quantifiable ranges to scenarios being discussed, as this extra level of depth will help separate your company and management team as leaders in the industry.***

4. U.S. focused businesses should benefit on a relative basis due to lack of exposure to parts of the world where economic slowdowns and other concerns are emerging.

While the U.S. remains strong, signs of weakness have begun to develop in certain areas of the world, though time will tell if they are emerging trends or temporary hiccups. Japan's economy contracted at a rate of 0.6% during the first calendar quarter for the first time in nine quarters. The EU, with Italian and now German political angst, has seen volatility exacerbated by a more hawkish ECB. Theresa May is now struggling with her political allies as Brexit negotiations persist, and

Germany's economic sentiment showed its lowest reading since 2012 during the second week of June. In South America, Brazilian trucker strikes have immobilized the country and Argentina, hat-in-hand, was recently granted a $50 billion bailout from the International Monetary Fund. All of this supports the notion that U.S.-oriented businesses will outperform over the near- to mid-term amid a robust economic backdrop if risk-return profiles of foreign markets tend to favor capital inflows to the U.S. ***This provides an important distinctive for U.S.-centric suppliers that can help you compete more effectively for investment capital and will remain an ongoing communication need for more globally focused entities.***

5. Tax and regulatory environment is favorable.

The Tax Cuts & Jobs Act is expected to result in $200 billion in tax savings for U.S. corporations, spurring $100 billion in additional capital expenditures in 2018 and an estimated $500 billion of repatriated overseas earnings. The current administration is also expected to propose a rollback of part of the 33% increase in 2022-2025 fuel economy standards. Major automakers have supported the "modernization" of Corporate Average Fuel Economy (CAFE) standards, noting that the first CAFE standard for model years 2022-2025 (54 mpg) were established in 2012 when oil prices were above $100/bbl and that sales-weighted MPG improvements have effectively stagnated beginning almost immediately with the correction in oil prices in late 2014.

The combination of tax cuts, both at the individual and at the corporate level, as well as a more relaxed regulatory approach should, when combined with other supportive macro-economic indicators, serve to further extend a healthy demand environment that is not currently showing any signs of cyclical strain. Auto suppliers with exposure to larger and often less fuel-efficient light trucks could benefit if the targets are adjusted, which in many cases will likely outweigh costs associated with other developments that the market is currently worried about. ***These important tailwinds to the current cycle are being lost in a tariff-dominated news cycle. In this environment, it is critical for corporate IR programs to push back against this flurry, providing a port for those willing to see through the chaos.***

6. Capital allocation focus and greater discipline across the group in this cycle point to important differences yet to be appreciated or reflected in valuations.

Suppliers have deleveraged since the prior cycle (1999-2006) showing a median Net Debt/EBITDA of 0.5x vs. 1.0x in the prior cycle, reducing risk in the group. Also, median pre-tax ROA is higher, 10.5% versus the previous cycle mark of 8.5%, suggesting suppliers have fundamentally transformed their models to become better businesses and more diligent stewards of capital. Median EPS growth from 2015-2017 has been 8.9%, beating the ’99-’06 mark of 6.2% for the entire auto supplier universe. Despite all of this, on a P/E basis, the group is trading at a 16% discount relative to the median multiple of the prior cycle (13.4x compared to 15.9x), indicating the auto suppliers space appears significantly undervalued compared to historic levels.

There remains a valuation dislocation between a cyclically sensitized group of auto supplier stocks and a broader market which, now in year nine of a bull market, does not share these same concerns when applied to the rest of the market. This dislocation is being exacerbated by a seemingly myopic compulsion to identify and run from an established peak demand data point, ignoring a more fundamental and broad-based set of indicators that point toward an extended cycle with overall healthy demand levels continuing. These factors show that auto supplier names are fundamentally sounder and, subsequently, less exposed to any downturn in macroeconomic or industry trends as compared to many other sub-sectors of the heavy industrial vertical.

While it’s the Street’s job to drive a company’s valuation, smart IROs will find ways to outline key capital allocation criteria, as well as to showcase the value in their stocks by using appropriate peer groups and performance data that highlights valuation opportunities for investors.

Best-in-class Auto Supplier investor relations programs are asking the following questions and thinking about these issues:

- Do my shareholders truly understand these issues and their ultimate impact on our valuation?
- What messages should I be adding or adjusting to shed better light on our industry and company?
- Are my investors focusing on the proper long-term drivers of our business?
- What methods should I be using to accomplish this goal (earnings, NDRs, conferences, analyst days, IR website, additional collateral)?
- How do I target new investors and ensure that all my communications on these issues are consistent?
- How do I ensure that the makeup of my shareholder base is consistent with my growth plan?
- How can we be more proactive in this environment, pushing an IR message about the business and the fundamentals of our company and industry that cuts through the fog of confusing information that investors are flooded with every day?
- As the economics of the sell-side these days work against the existence of tenured, senior and seasoned analysts who have "cycle experience" and can differentiate between the signal and the noise; how can I be more assertive by providing context and a relevant gauge to the wall of data flooding the markets?
- <u>A word of advice:</u> Do not assume that the meeting schedules at conferences and NDRs will naturally take care of themselves over the course of a year, generating a mean-reverting mix that somehow reaches a presumed target audience. The economics of the Street have long since shifted the playing field and a passive approach to IR will likely result in a lot of waisted management time and frustration. Take control of your schedule through a sophisticated targeting approach that is goal oriented and measured.

We Build

SMART IR

Programs Here

Big Agency Experience, Small Company Touch, Senior-Driven Consultations

About Alpha IR Group:

Alpha IR Group is a full-service investor relations consulting firm that partners with companies to deliver best-in-class investor relations, from strategic insights to daily, tactical execution. Alpha IR offers a range of tailored programs, as well as sophisticated insights and significant experience with activist preparedness, investor day preparation and execution, earnings support, M&A/transaction support, perception studies, and more. The firm's leaders have over 100 years of combined sell-side, buy-side, investment banking, and IR consulting experience. Alpha's growing staff supports a client base that spans seven industry verticals and represents over $100 billion of equity value trading on public exchanges in North America.

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