



## Holland Views – General Motors – Price: \$34, MCap: \$54bn

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### **What you win, when you win...**

The great John Templeton famously said about investment “*it is not whether you win or lose, but what you win when you win and what you lose when you lose*”. These words ring in our ears when we look back on our work on companies such as Bank of Ireland a few years ago and lead us today to General Motors (GM).

In the summer of 2012 we wrote a short piece (attached) on GM. In it, we observed that some of the world’s smartest investors were buying into the company and we reflected on what they might have seen. With the shares down recently due to product recalls and at the same time much excitement surrounding the appointment of Mary Barra as CEO we revisit the idea that there is value in GM. We are aware there are multitudes of analysts with impressive models looking at this sector daily; we therefore keep our views to a relatively high level.

We conclude that GM could be trading on PE’s as low as 2.5x to 5x (ex-cash) a couple of years out and that this value could be demonstrated via a combination of divisional ‘cancer surgery’, utilisation of deferred tax assets and, not least, an interest-rate led boost to GM’s pension deficits and capital structure.

### **In short we are bullish on GM, seeing much optionality**

An all-encompassing piece on GM, just on its market positions alone would likely take months to research and weeks to write up. We will leave that privilege to others who specialise in the sector. Firstly we observe just a few points of strength for the business below and then assess what opportunity could lie in front of investors if things went a little better than Mr Market currently suggests.

#### A reminder of GM’s attractions:

- A strong market share base:
  - Global market share is 11.6%
  - US market share is 17.1%
  - Market share of pickup trucks is 23.5%
    - US market share of large pickup trucks is c.34% (and the existing fleet of US trucks has never been older at 11.3 years– see Fig.1b)
  - Chinese market share is 14.3%
- GM’s China JV looks impressive, delivering a run-rate of c.\$1.8bn pa of cash to GM
- Group Return on Tangible Equity (RoTE) averaged 18% in last two years.
- Having emerged from bankruptcy, GM was able to reset cost overheads, write down assets and renegotiate with unions (note UAW own 9% of the shares)
- c.38% of GM’s global volumes are currently lossmaking
- GM’s new management seem very focused on further improving profitability by stemming losses in certain geographies. Examples include:
  - Closing a plant in Brazil by 2015
  - Closing a plant in Germany in 2014 to save \$250m
  - Exiting the Chevrolet brand in Europe

- GM capital expenditure is in line with depreciation meaning free cash generation is very similar to net income. We actually suggest 'Owners' Earnings' is greater than stated profits for reasons that will follow.
- Cash tax rate is significantly below the P&L tax rate.

#### What if management targets were plausible?

In Fig.1, we outline GM divisional profitability over the last two years along with the margin targets that management has set for these divisions to be reached by 'mid-decade'. Looking at the actions that have already taken-place suggests to us that stemming losses in Europe and international markets is an entirely plausible target. We admit to having less insight into the realism or sustainability of a 10% margin in the North American market. That said, we are intrigued by the potential for the group's operational earnings should such targets (that its management seem very confident of) be met.

**Fig.1 Current GM divisional profitability and management targets**

	Revenues		adjusted EBIT		EBIT margin		"Mid-Decade" targets
	2012	2013	2012	2013	2012	2013	
North America	89,910	95,099	6,470	7,461	7.2%	7.8%	10%
Europe	20,689	20,110	-1,939	-844	-9.4%	-4.2%	0%
GMIO (International)	22,954	20,263	2,528	1,230	11.0%	6.1%	
China JV	33,364	38,767		1,810	9.6%*	9.5%*	"higher"
RoW				-580			0%
Latam	16,700	16,478	457	327	2.7%	2.0%	5%

Source: GM 2013 10k

(\* China JV margins are Net Income margin – not EBIT, China JV sales are not consolidated in GMIO divisional sale above)

#### Why are we interested in GM?

Our thesis on GM is relatively simple. We do not and cannot know for certain whether management is wise, insightful or foolish to have the forecasts they do on each division's profitability uplift which were set out in 2012. We only that they have chosen to give them and appear most clear on how they will be delivered in each area via a combination of cost-cutting in lossmaking areas or better new product launches (a stated driver of the recent operational leverage in the US). Charlie Munger reminds us of the attractions of companies where the core businesses are temporarily over-shadowed by weak peripheral divisions.

*"I've had many friends in the 'sick business fix-up game' over a long lifetime. And they practically all use the following formula—I call it the cancer surgery formula: They look at this mess. And they figure out if there's anything sound left that can live on its own if they cut away everything else. And if they find anything sound, they just cut away everything else. Of course, if that doesn't work, they liquidate the business. But it frequently does work."* – Charlie Munger, 1994

To view the remainder of this in-depth report, please contact Andrew Hollingworth, [Andrew@hollandadvisors.co.uk](mailto:Andrew@hollandadvisors.co.uk) for a complete PDF copy.

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