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EDITED TRANSCRIPT

GM - Q3 2016 General Motors Co Earnings Call

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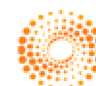

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the General Motors Company third-quarter 2016 earnings conference call. (Operator Instructions) As a reminder, this conference call is being recorded Tuesday, October 25, 2016.

I would now like to turn the call over to Randy Arickx, Vice President of Corporate Communications and Investor Relations. Please go ahead, sir.

Randy Arickx - *General Motors Company - VP Corporate Communications & IR*

Thanks, operator. Good morning and thank you for joining us as we review GM's financial results for the third quarter of 2016.

Our press release was issued this morning, and the conference call materials are available on the GM Investor Relations website. We are also broadcasting this call via webcast.

Included in the chart set materials published this morning, we've included key takeaways from each chart and the notes pages, in order to provide color on the results. This morning Mary Barra, General Motors' Chairman and Chief Executive Officer, will provide brief opening remarks, followed by Chuck Stevens, GM's executive VP and CFO. And then we will open the line for questions from the analyst community.

Before we begin, I would like to direct your attention to the legend regarding forward-looking statements on the first page of the chart set. The contents of our call will be governed by this language.

In the room today we also have Tom Timko, Vice President, Controller, and Chief Accounting Officer, and Dhivya Suryadevara, Vice President, Treasurer and Chief Investment Officer, to assist in answering your questions. Now I'll turn the call over to Mary Barra.

Mary Barra - *General Motors Company - Chairman, CEO*

Thanks, Randy, and good morning, everyone. Thank you very much for joining.

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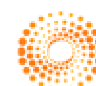

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GM delivered strong earnings and achieved several third-quarter records that included net income, EBIT-adjusted, EBIT-adjusted margins, EPS diluted-adjusted, and adjusted automotive free cash flow. Here are just a few of the year-over-year highlights.

Net income increased 104% to $2.8 billion as net revenue rose 10% to a $42.8 billion, which is an all-time record. EBIT-adjusted was up 14% to $3.5 billion. EBIT-adjusted margin was 8.3%, up 0.3 percentage points, and EPS diluted-adjusted was up nearly 15% to $1.72.

Adjusted automotive free cash flow was $3.8 billion, up from $0.8 billion last year. And ROIC-adjusted of 30.6% on a trailing four-quarter basis was an all-time record, continuing the positive impact of our disciplined capital allocation framework.

Given our outstanding performance this year, we are on track to deliver a record 2016 on top of a record 2015 and a very strong 2014. In addition, we expect to be at the high end of our full-year EPS diluted adjusted guidance of $5.50 to $6.00 per share.

We also completed our initial $5 billion share buyback commitment a quarter early and will be purchasing additional shares in the fourth quarter.

We had very strong performances in North America and China, so let me cover a few of the highlights. In North America, our disciplined retail focused strategy is paying off. US retail share grew 0.4 percentage points for the highest Q3 share in five years.

Chevrolet posted its best Q3 US retail performance in 10 years and Buick's best in 11 years. Our Q3 ATP of almost $36,000 exceeded the industry by nearly $5,000.

On the incentive front, although we are operating in an extremely competitive environment, we remain committed to our disciplined go-to-market strategy with a focus on retail customers, and Chuck will have more to say about that in just a few minutes.

We also announced the 2017 Chevrolet Bolt EV range of 238 miles at a price of $37,495 before tax incentive; so the final cost to customers can be under $30,000 depending on their tax situation.

We also have eight of the 2017 North America Car, Truck, and Utility of the Year semifinalists. We have the Cruze from Chevrolet and the Bolt EV; we have the GMC Acadia; we have the Cadillac CTS and XT5; and the Buick Lacrosse, Cascada, and Envision. I would also say just yesterday we had very strong results from Consumer Reports for Buick.

Even with the volatility from a market and pricing perspective as we look at China, China was able to post year-to-date retail sales and through September GM and its joint ventures delivered 2.7 million units, which is up 9% year-over-year. We had six new launches from our Chevrolet, Buick, and Baojun brands. Buick and Baojun set Q3 sales records, driven by the Excelle GT, the Envision, and the Verano notchback, and also for Baojun driven by the Baojun 560 and the 730.

In Cadillac, retail sales rose a record 79% in the quarter on strong sales of the XT5, the XTS, the ATS-L. And our year-to-date retail sales for China are up 35%.

For Europe, through the first nine months of the year we broke even. In fact, at the end of H1 we were on plan to break even for the full year.

Because of the UK referendum and the resulting devaluation of the British pound, we continue to expect that we will incur about $400 million impact in the second half of the year, and the team is working extremely hard to minimize the effect of this headwind. But even with the Brexit situation, our Opel/Vauxhall brands continue to show strength.

Through September, sales are up 5% year to date on the Astra's strong performance. And we also have introductions of the refreshed Mokka X and Zafira that are laying a foundation for future growth.

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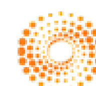

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In addition to the progress I reviewed so far, through Q3 we have realized $3.7 billion of the $5.5 billion target in cost efficiencies by 2018; and this is off a 2014 baseline. These savings will more than offset incremental investments in brand building, engineering, and the technology investments we are making as we launch new products in 2016 and beyond.

Because of the progress we've made, we are confident that we can exceed the $5.5 billion target. And we intend to use these additional savings to offset our investments in the future of personal mobility, where we see tremendous return potential.

We also are seeing positive results on our strategy to consolidate global architectures and powertrains. Production of the Cadillac XT5 and the GMC Acadia, the first two models on our new crossover platform, are nearly fully ramped up. The new Buick LaCrosse follows the Malibu on the midsize platform, and the Chevrolet Cruze hatchback variant is launching on the new compact car architecture.

Because these new global architectures and powertrains are so efficient from a mass and a fuel economy standpoint, we can use them for multiple lifecycles. This will enable significant reuse of our capital and the ability to deploy elsewhere in the business.

From the perspective of talking about personal mobility, we are leveraging our technical expertise in the core business to lead in the future of personal mobility for our customers. We are expanding our EV leadership with the Chevrolet Bolt EV and the Opel Ampera-e. They both go into production this quarter, and they'll surprise a lot of people in terms of performance, range, connectivity, and styling.

We are also testing 30 self-driving Chevrolet Bolt EVs on public roads in Scottsdale, Arizona, and San Francisco with autonomous vehicle trainers.

Our Maven personal mobility brand has seen rapid growth through its launch nine months ago. We expect to be in 15 markets by the end of 2016 with nearly 10,000 vehicles, and we've launched three services on the Maven platform: the City, Residential, and Express Drive variants.

70% of Maven's customers are Millennials that live in urban areas. And nearly 90 employees, 60 who are from outside of General Motors, 40% are Millennials, and they have collective experience of launching over 40 startups and as a team hold 117 patents. So we really have an energized team running our Maven business.

When we look at connectivity, we are building on our 20-year lead with OnStar. We expect to have nearly 12 million connected customers globally by the end of the year.

We've transitioned the OnStar remote link app our vehicle brands. Customer engagement is up, with 150 million interactions year-to-date versus the 135 million we had for all of 2015.

Lastly, we had nearly 500 customers that have enrolled in our Smart Driver service since its launch in July. They can use the service to anonymously seek insurance discount for good driving practices.

So every winning quarter we continue to demonstrate what the earnings power is the General Motors. The team's performance this quarter is further evidence that we are doing what we say we are going to do.

And with that, I'd like to turn it over to Chuck.

Chuck Stevens - *General Motors Company - EVP, CFO*

Thanks, Mary. I'd like to provide some perspective on the quarter and our results through the first nine months of the year.

In addition to another record quarter, we also put up some very strong results year-to-date. EBIT-adjusted through September grew to a record $10.1 billion, up $2.1 billion on a year-over-year basis. EBIT-adjusted margin was a record 8.3%, up 110 basis points year-over-year.

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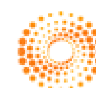

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The positive results were broad-based, with all but one of our automotive regions posting year-over-year profit improvement during the first nine months of the year. Our strong year-to-date results were led by record results in North America, sustained strong performance in China, and breakeven results in Europe. Our performance year-to-date clearly demonstrates that we're on track to meet our commitments and deliver another year of strong results.

In North America, EBIT-adjusted grew to a record $9.4 billion for the first nine months of the year, up $1.2 billion year-over-year. Our EBIT-adjusted margin was a record, at 10.7%, up 20 basis points year-over-year and in line with our target of sustaining strong margins of 10%-plus for the year. In fact, North America has achieved 10%-plus EBIT-adjusted margins for five out of the last six quarters.

The underlying strength of the US industry continues to support our strong earnings in North America. We expect the US light vehicle industry to be in the low to mid 17 million SAAR range for the year. And we also continue to expect the industry will remain strong, albeit in a plateau environment over the next number of years.

However, given the recent increased interest in industry incentive and inventory levels, I'd like to spend a few additional minutes to share our view. Clearly we recognize the industry is increasingly competitive, especially as consumer preferences are shifting away from sedans and more towards SUVs and trucks.

We remain absolutely committed to our disciplined retail focused go-to-market strategy, and we have demonstrated that by managing supply and demand and through disciplined pricing. In fact, on average, our third-quarter incentives as a percentage of transaction price significantly underpaced the industry. GM was up 30 basis points year-over-year, but the industry was up 80 basis points year-over-year.

Furthermore, our transaction prices increased at approximately twice the rate of industry during this time period.

Q3 incentive levels were influenced by our selldown of the 2016 model-year vehicles, resulting in a model-year changeover pace ahead of where we were last year. Current model-year product now makes up more than half of our dealer inventory, which is approximately 15 points better than last year's status at this point in time.

Our aggregate dealer inventories are up year-over-year, increasing the availability of our recently launched products like the Cadillac XT5, GMC Acadia, and the Chevrolet Cruze and Malibu. And given our dealer footprint, our days supply is well positioned at 79 days, as it's important to have sufficient inventory as we move into the strongest seasonal pickup market, coupled with holiday-related downtime, in Q4.

Looking ahead to Q4 and beyond, we would expect aggregate dealer inventory levels to remain higher than a year ago as the industry remains strong and we build dealer stocks ahead of our upcoming crossover launches in 2017. We also expect days supply to fluctuate before moderating by year-end.

Having said that, as we've demonstrated in the past, our inventory levels will be dictated by matching supply with demand. We will continue to watch inventories closely, especially cars, and will take actions if and when required.

We also expect our incentive levels to moderate in Q4 as we benefit from a higher mix of newer-model sales, increased availability of our most recently launched products, and an expected strong finish to the year for US industry SAAR levels.

As you may have already seen, incentives as a percentage of transaction price for the industry are trending down in October, per J.D. Power's midmonth data. And our incentives as a percentage of transaction price are also expected to trend down as we progress throughout the month and the rest of the quarter.

It's clear our go-to-market strategy is working, and we remain confident in the health of the US industry. Okay; let's move on to the rest of the world.

China continues to deliver solid results, with equity income of $1.4 billion for the first nine months of the year, about equal to a year ago, with net income margin remaining strong at 9.3%.

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In South America, as you all know, macroeconomic conditions remain challenging. We continue to work to offset these pressures and take the necessary steps to set us up for future success.

Our efforts are paying off. In spite of the challenging environment -- worse than what we experienced in 2015 -- the team has narrowed losses by nearly $300 million this year compared to 2015.

Shifting to Europe, despite the ongoing effects of Brexit, the region posted breakeven results for the first nine months of the year, an improvement of $500 million year-over-year and the best performance year-to-date since the third quarter of 2011. Clearly we have made substantial progress towards our breakeven target in 2016.

However, we continue to face headwinds related to the UK referendum. And as all of you know, the British pound continues to fall to lows not seen in decades.

As we indicated back in the second quarter, we continue to estimate that Brexit could have a negative impact of up to $400 million in the second half of 2016, which includes over $100 million already incurred in the third quarter. The team continues to remain focused on making progress in our turnaround plans in Europe, and we will continue working to partially offset these headwinds to the best of our ability.

Turning to cash flow and capital allocation, adjusted automotive free cash flow grew to $5.2 billion for the first nine months of the year, up $2.7 billion year-over-year. These results include an increase of $1.5 billion in capital spending as we make portfolio investments in our product lineup, consistent with our previously communicated plan.

As a reminder, Q4 cash flow tends to be weak due to seasonality. However, we remain on track to generate approximately $6 billion in adjusted automotive free cash flow for the year.

Our strong cash flow generation and earnings growth continues to support a significant return of capital to shareholders, in line with our capital allocation framework. We've returned $3.3 billion to shareholders through the first nine months of the year, including $1.8 billion in common stock dividends and $1.5 billion in share repurchases, completing our initial $5 billion program ahead of schedule.

We expect to repurchase additional shares in the fourth quarter as we work towards the $4 billion in share repurchases we committed to completing by the end of 2017.

Finally, with regard to our outlook for the remainder of 2016, given our very strong year-to-date results and our current outlook for Q4, we now expect 2016 full-year diluted earnings per share adjusted to be at the high end of the $5.50 to $6.00 range per diluted adjusted share. It is clear that we've accomplished a lot already this year, and we fully expect 2016 to be another record year for the Company.

We are in the process of finalizing our 2017 planning assumptions, and we'll provide you with additional color in January on what to expect for the year. However, we do expect a continuation of strong earnings in 2017 as North America's results will be favorably impacted by our strong launch cadence of new crossovers as well as the continuation of positive cost efficiencies around the globe.

That concludes our opening comments. We'll now move to the question-and-answer portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Itay Michaeli, Citi.

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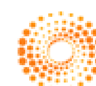

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Itay Michaeli - *Citigroup - Analyst*

Great; thanks. Good morning, everyone. Chuck, when you just touched on 2017, I know it's early for guidance in detail; I think the slides do still talk about GM expecting a positive earnings trajectory. So is the initial thought is that earnings can still go up next year versus this year? And then maybe if you can, give us a little bit more details on the various puts and takes to think about when modeling 2017.

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes, you know, Itay, we'll have more to say at the Deutsche Bank conference in January, specifically around the details on how we see earnings shaping up in 2017. But with that said, absent an unforeseen economic development either in the US or China -- and we certainly don't foresee any -- we would expect GM to deliver improved EPS-diluted adjusted in 2017 which is consistent with what we've been talking about for some time now.

Itay Michaeli - *Citigroup - Analyst*

Great; that's very helpful. Then just secondly, can you help us a little bit more to think about how you're thinking about China in the fourth quarter? Given the environment and the tax incentives, as well as what you are seeing in terms of inventory levels and pricing going into the fourth quarter.

Chuck Stevens - *General Motors Company - EVP, CFO*

Well, I would say there's certainly uncertainty around the tax incentive and when that may end, and that had an impact on the strength of the Chinese market calendar year to date. Absent some announcement by the government, we expect Q4 to be strong as well, in the range of 9% to 10% up year-over-year.

We've seen so far in October the industry and sales continue to run very well. We still expect to see strong equity income, consistent with our guidance to generate about $2 billion of equity income for the year.

Pricing continues to be a significant challenge. We've been able to offset that on a year-to-date basis with improvements in mix and continued material cost efficiencies. So it feels to me more of the same in the fourth quarter, consistent with what we've seen in the first three quarters of the year.

Itay Michaeli - *Citigroup - Analyst*

That's very helpful. Then just lastly, maybe a strategic question for Mary. I think last month John Zimmer from Lyft predicted that the majority of Lyft's rides will be autonomous within five years.

I was curious if that comment is part of your plan with Lyft in terms of the on-demand network partnership. Maybe if you can just give us an update on how you're looking at trajectory on these efforts going forward.

Mary Barra - *General Motors Company - Chairman, CEO*

Sure. We are making great progress on the autonomous development. As I mentioned, we have a fleet now running not only in San Francisco but also in Scottsdale; so 30 vehicles on the road.

And that's important because it's not just the miles, but it's really the experiences and the scenarios that they continue to learn every day. I'm very pleased with the team's performance.

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As we look at launching autonomous into the marketplace, we believe it will first happen in a controlled environment, in a ridesharing environment; hence the alliance that we did with Lyft as well as the work that we're doing with Maven.

But as we see it going into ridesharing, that's because it will be geo-fenced. They're going to have limitations with speed and other limitations. And that's why the ownership will stay with the Company in these first models as we continue to learn.

So that path is very much on track. But I will say what is going to gate our launching of autonomous vehicles into the marketplace for consumers is safety. We are working very hard with the experience that we have to do that in the safest manner possible, because it does then really address the issues that we have of over 90% of fatalities in today's US streets are human error.

So we think we can make a big dent on that, so we'll be gated by safety. But once we feel that we've got the right system, working with our regulators, we have the scale to put those vehicles into production extremely quickly.

Itay Michaeli - *Citigroup - Analyst*

That's very helpful. Thanks so much, everybody.

Operator

Rod Lache, Deutsche Bank.

Rod Lache - *Deutsche Bank - Analyst*

Good morning, everyone. I had a couple questions. One is just I was hoping you can elaborate a little on the outlook for pricing and profitability in North America. You've done a very good job of keeping inventories at good levels and have had really good results on pricing.

Of course, everybody is noticing some increasingly aggressive actions from competitors. RAM incentives are at 16% of average transaction prices; this quarter we're seeing a number of retailers talking about margin compression in new.

This morning, FCA talked about over 600,000 units of additional truck capacity in 2018, and I think IHS is projecting something like 13% increase in GM production in Q4. So I was hoping just in the context of all these things that we all see, can you talk about, number one, the GM production outlook?

And maybe a little bit more on the levers that you can pull to sustain 10% margins in North America as we look out to next year.

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes, sure. Let me start at 10,000 feet and work my way down a little bit.

I already spoke to our inventory level, and we feel our inventory level is appropriate given our dealer footprint and what's really driven the increase in inventory, which is filling out inventory on newly launched products, some new entries that we didn't have before -- like the CT6 or the Envision, as an example -- and continuing to work on inventory for our compact crossover so that we have a sufficient supply as we look to change those models over in 2017.

From a pricing incentive perspective, clearly the market in general is getting more competitive and there is some aggressiveness from a truck perspective. But I step back and look at the overall strength of our three truck strategy: the light-duty, heavy-duty, and midsize trucks. We've been able to maintain discipline around that, grow retail share, and increase our transaction prices in spite of some of this.

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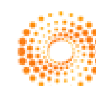

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I think it's fundamentally driven by the very, very strong product. Relative to the truck capacity coming onstream, we could sell more vehicles if we had more vehicles from a truck perspective today; and hence one of the clear focus areas on the retail side of the business.

You also need to peel the onion a bit on where is the industry actually adding capacity? Is it in trucks? Is it in SUVs? Is it in crossovers?

Because again we believe we are well positioned. We have dominant share in full-size SUVs, and our full-size pickup trucks continue to perform very well.

To your last point, or how do we continue to see earnings be sustained from a North American standpoint -- and I think there's two or three fundamental drivers of that, Rod. Number one, we're running a different play and it's generating different results.

We're very focused on retail in a very disciplined way. Our retail market share is up.

We're less reliant on less profitable daily rental, and that's showing up in our results. We also have our very, very strong product launch cadence.

This year we fundamentally rolled over our entire passenger car portfolio, and next year we'll start the strong launch cadence of completely refreshing crossovers -- small, compact, and midsize -- over the next 12 to 18 months. And that's critical. That's a lot of volume; it's highly profitable; and we expect to see that.

We also expect to see continued improvements from a cost standpoint. North America fundamentally enjoys the large benefit of that $5.5 billion of cost efficiency. And as Mary indicated, we're looking to drive that even higher. And that's going to be fundamentally from a material performance, logistics performance, and we'll continue to streamline manufacturing and SG&A.

Taking all that together, we're confident and constructive that under a plateaued industry environment that we can continue to sustain strong margins in North America like we have done over the past couple of years.

Rod Lache - *Deutsche Bank - Analyst*

Thank you. Could you confirm what IHS is calling for vis-a-vis GM's Q4 production?

And, on a separate track, if you can, maybe talk a little bit about scenario planning for China. Right now your volume is up 9%; there's been some margin pressure, which you guys have pointed to. But you're keeping earnings flat.

I'd imagine that to some degree there's some demand pulled forward. So if we were to think about a flat market in China or something significantly flatter, how would that affect GM's equity earnings outlook?

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes, let me -- when you're talking about fourth-quarter production, are you talking about total or trucks or what?

Rod Lache - *Deutsche Bank - Analyst*

IHS is calling for North America production in the fourth quarter for GM to -- the last I checked I think it was an October update of being up 13% year-over-year. I'm not sure if that's correct, but it seems like a fairly big increase just given the trends that we've been observing.

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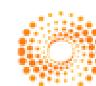

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Chuck Stevens - *General Motors Company - EVP, CFO*

Yes, as we work through the launch cadence of our recently launched products, we would expect overall production to be up in the fourth quarter marginally from the third quarter. Obviously, what plays into that are the Christmas holidays and everything else. But we would expect production to be up.

Relative to China and the specific questions around planning assumptions in China, we've been able to maintain strong equity income and strong margins through continuing to launch new products, improve mix and material performance, which has fundamentally offset price headwinds. Obviously, this year the industry is running stronger than we expected because of some uncertainty around the purchase tax incentive.

If that was to end, and the government was to announce an end to that, our planning assumption would be that there could be some volatility in maybe the first and second quarter of next year. But we would still expect the industry to continue on that growth path towards 30 million units and, as we've talked before, a little bit more volatile growth pattern and in the low single-digit range over the next number of years.

Again, it really depends on what's announced from the government's perspective, and we have no insight on that. We certainly expect the pricing dynamic to continue, and that's why we are so focused on our product launch cadence.

I would say, similar to the US, our product launch cadence in China is heavily weighted towards SUVs and crossovers over the next number of years, as well as Cadillac products, which is going to help from a mix standpoint.

All that said, more to say in January around specifics; but we would expect China equity income to continue to be strong. We would expect margins over time to be compressed -- they are at somewhat unnaturally high levels from an industry perspective for the foreign OEMs -- but still be generating strong overall equity income.

Rod Lache - *Deutsche Bank - Analyst*

Great, thank you.

Operator

John Murphy, Bank of America Merrill Lynch.

John Murphy - *BofA Merrill Lynch - Analyst*

Good morning, guys. Just a first question on truck pricing, because there seems to be some hyperbole around elasticity of demand to pricing. I'm just curious.

When you think about pricing on trucks and what you're seeing in the competitive environment, I mean, if one competitor cuts price, do they tend to pull forward their own demand? Or do they tend to conquest sales?

I'm just trying to understand what's going on here. Because it really is -- there seems to be a belief that price-cutting can drive significant conquesting. I'm just curious how you think about that.

Chuck Stevens - *General Motors Company - EVP, CFO*

Well, I think that you really need to peel the truck market down almost cab type by cab type and trim level by trim level. Because price elasticity, in our view, becomes less relevant the more you move up from a trim-level perspective and a cab-level perspective.

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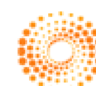

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First, truck buyers are the most loyal of any customer. The loyalty rates of truck buyers are north of 60%, and generally you're in the 50% range. So that's first: you're dealing with that aspect.

Second, where there seems to be the most elasticity is at the very low end of the market, so regular cab work-type trucks and things like that. I think that you saw some of that play out last year when one of our competitors was very aggressive and we were losing share at the lower end but still generating strong profits and good transaction price growth. I think that's what we're seeing play out.

So I wouldn't paint the whole truck market pricing dynamic with one brush. You almost need to look and peel that onion back a layer or two.

We're still performing exceptionally well up-level crew cab, our new up-level additions and higher trims that we're rolling out. And we've seen improved transaction prices and improved actually profitability on the current truck platform on a year-over-year basis and despite some of the challenges at the lower end of the market.

John Murphy - *BofA Merrill Lynch - Analyst*

Okay; that's very helpful. Then just a second question. Could you just give us your leasing levels in the third quarter in the US, or a percentage of sales, and what you think the industry roughly was in the quarter?

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes. The industry was -- and this is broad strokes, John, but I think directionally correct -- in the 27%, 28% range and we're a little bit lower than that from a leasing perspective in Q3. 24% for us.

And that's down from highs earlier this year of close to 30%. So typically we would be a few percentage points below the industry average just because of the mix. Less trucks are leased, so -- but that's where the dynamic is at.

What we're seeing is lease penetration at an industry level is up the same amount that subvented financing is down, as the market is dealing with low interest rates and people are still looking for payments that they used to get through subvented financing.

John Murphy - *BofA Merrill Lynch - Analyst*

Got it; that's helpful. Then just lastly, on cap allocation, I personally would pretty much agree with the way that you're going after this. But clearly what we're seeing in the stock is the market is maybe disagreeing with cap allocation and where we are in the cycle.

I'm just curious. Would you ever consider storing more of this cash on the balance sheet to create a larger buffer and maybe calm some market concerns, which appear to be out there given what the stock is doing, and maybe taking advantage of a buyback or redistribution of capital to shareholders as the cycle progresses and maybe goes to the downside?

Or are you going to stay on this stalwart path of $10 billion roughly of net cash; and excess free cash flow above and beyond that will just be redistributed through buybacks?

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes, you know, we did a lot of work around our original capital allocation framework and the target $20 billion of cash. We looked at the business; we looked at what it was going to take to run the business through the cycle, to ensure that we could continue to invest appropriately through the cycle -- because that's one of the lessons learned -- and to ensure that we could maintain the dividend through the cycle, through a typical 25% downturn. That is the basis for our targeted cash.

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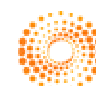

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We will continue to reevaluate that depending on market dynamics -- and we do on a regular basis. But there was a lot of work to come up with that $20 billion.

And fundamentally, we're making all the investments that we want to make from a capital spending perspective. We're making the investments we want to make from an innovation technology standpoint.

And at the end of the day, $20 billion is what we really need to run this business and manage it through a cycle, maintain the dividends. So under that construct, what's available from a free cash flow perspective should come back to our owners.

And we also have a revolver. Obviously, our intent was not to draw that in a downturn, but that's an emergency backstop in the event of some unforeseen issue or a deeper-than-typical downturn, and that's available to us as well.

John Murphy - *BofA Merrill Lynch - Analyst*

I'm sorry, Chuck, just one follow-up on that. You talked about $20 billion of gross cash. You didn't mention the net cash.

Is there a potential that you would consider taking on some leverage to buy back the stock? Right now the market cap is 2.8 times your trailing EBITDA; it's pretty inexpensive (technical difficulty) growth basis right now.

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes, going back to our overall capital allocation framework, first and foremost invest appropriately in the business through the cycle to drive sustained 20%-plus return on invested capital and invest in the future for technology and innovation. Second, maintain an investment-grade balance sheet. And we're targeting to run the Company at a single-A rating because we think that's the right thing to do from a financial risk management perspective and to support GM Financial, which will ultimately lead to significantly improved earnings at the finance Company but also at the car Company.

So we don't -- we feel today when you look at our overall external debt and the position of our underfunded pensions that we have, the appropriate amount of leverage, we do not want to overlay financial leverage on top of operating leverage in this business. Because that's another lesson learned from the last significant downturn that we went through.

John Murphy - *BofA Merrill Lynch - Analyst*

That's very helpful. Thank you very much.

Operator

Ryan Brinkman, JPMorgan.

Ryan Brinkman - *JPMorgan - Analyst*

Thanks for taking my question, which is on Europe. I think that the guidance back in July was maybe $400 million of Brexit impact in the back half of 2016 or $800 million annualized; but it looks like you called out just $100 million in 3Q, or more like $400 million annualized.

So with a quarter's worth of result in Europe post-Brexit, do you now have a different assessment of the annualized financial impact? September SAAR in Western Europe I think was, like, the strongest since May of 2009. I wonder if maybe when you guided to the annualized impact back in July if perhaps you'd assumed lower industry volumes that have yet to -- at least so far -- materialize.

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Chuck Stevens - *General Motors Company - EVP, CFO*

Yes, let me go back to what we talked about in July, because I think it was you that asked the question, Ryan, when we were talking about the $400 million impact in the second half of the year, and you kept pushing me on what is the calendar impact. And I think I said: early days but an indication would be, take the $400 million and multiply it by 2 right? A full-year impact of the second-half pound sterling only, without a lot of insight on what was happening from an industry perspective and everything else.

And I'll circle back to that in a minute, but I just wanted to set the foundation for that $800 million. It wasn't a well-studied kind of guidance; it was a general directional answer to a conversation you and I were having on the last earnings call.

We did guide to the second-half impact of $400 million. We are holding to that guidance.

What manifested itself was $100 million in the third quarter; so that would leave a residual $300 million in the fourth quarter on the basis of our crystal ball today on where we're landing from a pound sterling perspective.

The reason it was more back-end-loaded, obviously we had some hedges in place that helped in the third quarter to mitigate that to a certain extent. And the pound has weakened further since we provided that guidance.

So we still expect for the second half of the year in the range of a $400 million headwind associated with Brexit, primarily related to the pound sterling. And that's primarily now a fourth-quarter issue; about $300 million of that residual would fall into the fourth quarter, which will certainly make our challenge of breakeven in Europe very, very difficult, especially when you think about the seasonality of earnings and everything else.

Just looking at the pound sterling impact itself, pick an exchange rate. At the end of Q2, we're at $1.28, $1.29; the last I checked this morning we were at $1.22.

There is a several hundred million dollar headwind on our long pound sterling position. That in and of itself in 2017, if I was picking a point today, would be significant.

But there are a number of actions that we're working through with the European team to mitigate as much of that as we can. More to come in January; but certainly the environment in Europe is challenging and uncertain and very volatile at this point in time.

From an industry standpoint, I agree with you that performance in Western Europe has been strong, and strong through the third quarter. And, frankly, it was even strong in the UK.

But again when you look at the sales there were a lot of fleet sales in Q3, of lot of very unprofitable fleet sales in Q3. We didn't necessarily participate in it, but there is a lot of inventory being unloaded.

I would expect and we still expect to see the industry pull back as we exit this year and go into next year, to a certain extent, as OEMs start to price. We raised prices 2.5% on October 1. Our intelligence suggests Volkswagen followed -- not to that full level, but followed as well.

And that in and of itself, along with consumer sentiment issues, will drive some pullback from an industry standpoint. So we'll have to see how that plays out.

Ryan Brinkman - *JPMorgan - Analyst*

Very hopeful color. Thank you. My final question is on consolidated international operations. Looks like the loss there, it narrowed quite a bit sequentially. That was actually the biggest difference versus our model.

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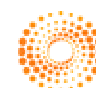

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So what is the plan and the cadence to walking this region back to, say, breakeven? Maybe remind us of the timing and the magnitude of the savings coming from winding down manufacturing costs in Australia.

And if you could share, if there are any other catalysts or step changes in profitability in the region that investors might have to look forward to.

Chuck Stevens - *General Motors Company - EVP, CFO*

Well, I would say our approach in all of our operations, including the consolidated operations, is to put in place a path to drive these businesses to viability and appropriate returns; and if not, to take action.

Exiting manufacturing in Australia was one of those. We should be through that by the end of 2017. All else equal, that would be worth $100 million to $150 million a year in savings from a manufacturing cost perspective once we exit that activity.

Again, scheduled at the end of 2017. We've already exited or significantly downsized our vehicle manufacturing, car manufacturing activity in Thailand. We ceased manufacturing in Indonesia.

I would suggest we are looking at all of our operations there, and as we've indicated in the Q there could be additional significant restructurings depending on whether we can identify a path forward, because we're just not going to absorb the kinds of losses that we've seen there on an ongoing basis.

So I would suggest there is likely more actions to come.

Ryan Brinkman - *JPMorgan - Analyst*

Okay, thank you.

Operator

Adam Jonas, Morgan Stanley.

Adam Jonas - *Morgan Stanley - Analyst*

Hey, Mary. I've got one for you first, and I'd be particularly interested in your answer to this question as an engineer by training and profession. So, as the ADAS -- and the question is about ADAS, cars still with steering wheels but a lot safer. Our dialog with suppliers and regulators, especially as these systems mature in the market and they get the data to show the vehicle-to-vehicle and vehicle-to-pedestrian empirical data, the reductions are very significant, sometimes 30% or 50% depending on the accident.

My question for you is: Mary, how much does it cost per unit to make your vehicles order of magnitude, like, a third safer? 30% or 50% safer?

Is it hundreds of dollars? Is it $1,000? Or is it in the thousands of dollars? Just order of magnitude.

Mary Barra - *General Motors Company - Chairman, CEO*

Adam, we don't really disclose that type of pricing from a technology perspective. What I would say is, if you look at our vehicles, there's tremendous safety features on them already, whether it's airbags or the lane detection, automatic emergency braking, rear-object detection even when you back up from a perpendicular perspective. And a lot of the technologies on the vehicle today that we have put on and offset to a large extent the technology for safety by finding cost improvements, material cost improvements, and just overall design and efficiency of the vehicle.

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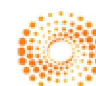

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So -- and the way I look at it is all this technology is making the driver safer today on the roads. We'll continue on that journey.

But I think the real step function happens with autonomous. Because you really then get to a point -- again, if you've implemented autonomous very safely and really understand all the dynamics that will happen, there's an infinite number of situations that drivers or vehicles will see, and how you respond to those is going to be critical. That's where you get the step-function improvement.

So I don't see it as it's $300 gets you this; $500 gets you this. It's not really the way we look at it.

We continue to look at how do we incorporate the safety technology into the vehicle, looking at affordability today. And then with a -- and I would call that the evolutionary path. And then autonomous is more of the revolutionary path.

We're working to drive those costs down. But again, we haven't shared those in detail.

Adam Jonas - *Morgan Stanley - Analyst*

Okay. Well, the reason why I ask is because, although fully autonomous is a noble initiative, and it's coming, and to get the real, real 95% to 100%, near-100% type reductions, it seems we can't -- if there are technologies that are vastly easier to implement and more affordable in an ownership model that can lead to a 50% reduction, that's worth implementing as well. It just raises industry questions about the insurability of the vehicles that you are selling today without these systems, and the value that they would have in the secondhand market. We'll continue that discussion.

Chuck, a question for you then, lastly. You mentioned the goal of $6 billion of adjusted auto free cash flow. When I look year to date, though, and take the $10 billion of automotive operating cash flow and I take out CapEx, I get a number of $3.2 billion. So I guess when you say adjusted there some changes you're making to that number; because you're not implying you're going to make almost $3 billion of free cash flow in the fourth quarter. Is that fair?

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes. The noise in that is pension, so on --

Adam Jonas - *Morgan Stanley - Analyst*

Oh, okay. All right.

Chuck Stevens - *General Motors Company - EVP, CFO*

So you've got to -- we funded that with debt. So you just add the $2 billion to the $3.2 billion, you get $5.2 billion of free cash flow ex-pension contribution.

Adam Jonas - *Morgan Stanley - Analyst*

Okay. Because those pension contributions -- I mean, because I guess the big investor question we're getting is: That is a competition for the cash, right? And even if it's not every year, they are with some regular frequency.

So like last year you made $5 of earnings; but the free cash flow per share, including the pension contributions and a lot of other unusual stuff, okay, was about $1.30. So there was a big gap.

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You're narrowing that gap this year. Maybe if you include the pension funding, you're getting close to half; you narrowed it to maybe if you do $6 of earnings maybe you do $3 of free cash flow a share. But you still have that gap.

So the question, Chuck, is: How will this gap -- will this gap be narrowed so that your $6 or so of earnings can really reflect cash earnings as well? And what are the factors you think that can drive the narrowing of that gap? Thanks.

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes. First, just let's go back to the pension. Just to be clear, that was a debt-for-debt funding, right?

And for display purposes, on a GAAP basis it's taking out of operating cash flow; obviously free cash flow would add back in because it's debt-for-debt. So the $5.2 billion is the right GAAP -- or the right adjusted free cash flow number and consistent with our $6 billion target free cash flow at the end of the year and what will apply to our capital allocation framework.

When you look at our overall difference between EPS and cash, obviously we have cash taxes; and that's going to be and has been roughly $1 billion a year. Capital spending is higher than D&A because we've underspent for a number of years and it's going to take a while to catch that up.

And pensions. At the end of the day, we have pension income that is noncash that gets reversed.

So I would say that as we look forward, the way I think about it is our conversion ratio should improve on a go-forward basis because incremental EBIT is highly levered to cash flow on a go-forward basis. And that's what I've talked about before.

Adam Jonas - *Morgan Stanley - Analyst*

So the gap has got to be driven by operational improvement. There is nothing else in the adjustments that you see improving that gap. That's how I'm interpreting that.

Chuck Stevens - *General Motors Company - EVP, CFO*

Well, over time there will be puts and takes. D&A is going to obviously catch up, and our cash tax rates will -- or our ultimate cash tax payment will increase versus where we are today over time. And we'll start to accrue GMF dividends.

But over the next two or three years, it's going to be operational improvement and leverage.

Adam Jonas - *Morgan Stanley - Analyst*

Okay. Thanks, everybody.

Operator

Brian Johnson, Barclays.

Brian Johnson - *Barclays Capital - Analyst*

Yes, good morning. A quick housekeeping question then a more strategic question.

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The housekeeping is, Chuck, you'd mentioned fourth-quarter production could be sequentially up. Just to clarify, IHS, the forecast that a lot of us use, has you up 14% year-over-year in 4Q in North America, but down somewhat sequentially just given the holiday. So just want to clarify what you're expecting.

Chuck Stevens - *General Motors Company - EVP, CFO*

We expect sequentially 2016 Q4 versus 2016 Q3 to be up slightly, maybe 3% on an FUS basis, right, a factory unit sale basis, which would be production plus imports. Versus 2015 Q4, it looks like we'll be up 150,000 units or so, all things equal, on the basis of our outlook right now.

Brian Johnson - *Barclays Capital - Analyst*

Okay. The more strategic question is China over the summer is maybe more noise about new energy vehicles. Europe, culminating in the German Bundestag floating an idea of eliminating ICE sales by 2030.

So aren't your actions just three propositions? One, do you think there is a realistic possibility that China and Europe actually get the easy penetrations mid next decade, well ahead of the US?

Two, given their penchant for favoring the home team, how are you positioned? And in particular, we hear most of what you're doing around electrification and autonomous for US markets; but how are you thinking about those internationally?

And, three, how do you think it's going to affect the mid-term, the longer-term profitability of those regions?

Mary Barra - *General Motors Company - Chairman, CEO*

Clearly China -- we believe that China is going to lead in the penetration of electric vehicles into the market, and that's why we've announced that we have 10 new energy vehicles coming out. I would say we're also the only OEM that actually manufactures batteries in-country right now.

Clearly we have the strength of the products that we have available to sell globally with the second-generation Volt as well as the Bolt EV and the Ampera-e, along with many other electrified products in China. So we definitely see that trend.

I think one of the things, though -- and this is where we also have an advantage with our PATAC engineering center, that we can really leverage the supply base and that volume in China to really help us globally from an electrification perspective. And we intend to do that.

I would also say from a European perspective we definitely are seeing more of a move, and we'll be announcing the Ampera-e next year that -- with some of the different issues associated with emissions there is a much stronger interest and focus on electrification.

To say who is going to be -- we clearly think the highest market will be China. I think we'll see progress in both the US and Europe.

I would also say, though, we've got some very good diesel products that we're launching, both cars and trucks, that are getting very good market reception. So I think it's too soon to exactly call how the penetration is going to be, but definitely probably more significant than we thought maybe a year or two ago.

And as it relates to -- clearly we've got to get the scale and get the engineering work done that we can have minimal impact from a margin perspective.

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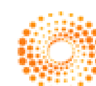

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Brian Johnson - *Barclays Capital - Analyst*

Okay. I guess similar for autonomy, do you think China will accelerate and maybe not surpass the US, but pull even with it, just given the density of the populations in the urban centers?

Mary Barra - *General Motors Company - Chairman, CEO*

Again, there's so many issues that have to be resolved to be able to say who's going to be first. Not only is it getting safe technology deployed -- and I think we're in an excellent position, that we intend to be among the first or the first with safe autonomous vehicles, and then we do have the capacity to build those at scale.

But you have to look at how the regulatory environment will impact around the globe. And in China there are some certain restrictions to mapping technology as well. So I think there's a lot to play out to right now call who is going to lead.

Brian Johnson - *Barclays Capital - Analyst*

Okay, thanks.

Operator

Joe Spak, RBC Capital Markets.

Joe Spak - *RBC Capital Markets - Analyst*

Good morning. Thanks for squeezing me in here. The first question was just on the incentive spending commentary in North America -- or in the US, I guess, that you mentioned earlier, down as a percent of ATPs in the fourth quarter versus third quarter. And you mentioned the October data point.

But first of all, isn't that always the case at this time of year, as the model mix changes? I guess what I was wondering is if you could give us a sense of if you believe on a like-for-like basis incentive spending for the industry and for GM will be flat, up, or down on a year-over-year basis in the quarter.

Chuck Stevens - *General Motors Company - EVP, CFO*

Well, I guess I would just look at the trend year-to-date. The trend year-to-date is that the industry, the incentive spend as a percentage of transaction price, through the first three quarters of the year is up on a year-over-year basis -- off the top of my head, 60 to 70 basis points, so somewhere from a 10.6% to an 11.3%. We're generally in that range as well, maybe at 11.4%.

I would expect -- and you're right; typically depending on how the model changes are going for all the competition, Q4 has a tendency to ramp down a little bit because you've launch the new model-year vehicles. For us, specifically, because we're in really good shape from that perspective, but we'd expect the industry broadly to follow that same trend, but I'd also expect on a year-over-year basis it will be up, consistent with what's happened in the first nine months of the year.

Joe Spak - *RBC Capital Markets - Analyst*

Right, okay. Then one quick one on the free cash flow guidance, which I know you reiterated for this year; and I think back in January over 2016 to 2018 you called for a $6 billion to $7 billion range. A, I guess I want to understand if you think that range is still valid.

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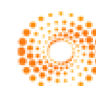

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Then I know, Mary, at the beginning of the call you said some of this, some investment might be funded by greater-than-expected cost efficiencies. But can you give us an indication of how much within that $6 billion to $7 billion is actually a headwind from spending on items such as electrification, autonomous, or other ventures?

Chuck Stevens - *General Motors Company - EVP, CFO*

Well, one, we'll have more specific guidance on beyond 2016 in January. But generally speaking, we would expect to generate strong cash flow over the next number of years, and we haven't changed our perspective on that. And this year, $6 billion is -- we're on track to deliver that.

Relative to the second question, and I'll let Mary speak to it as well, but free cash flow is after we make investments and everything else. So obviously if we expect to continue to maintain strong cash flow, that's after we've funded investments in autonomous or engineering for autonomous or future technologies, just broadly speaking.

Mary Barra - *General Motors Company - Chairman, CEO*

That's absolutely correct.

Joe Spak - *RBC Capital Markets - Analyst*

Yes. I guess what I was wondering is -- said another way, how much higher would it have been if you weren't making the investments (multiple speakers)?

Chuck Stevens - *General Motors Company - EVP, CFO*

Yes, I kind of figured that was your question, and I'm not quite ready to -- think we're ready to go out and start to say we're investing X on autonomous vehicle or future technology engineering. Because you've got to -- what technology are you speaking to, specifically?

I would suggest versus the previous plan, as we've really started to ramp up our activities around autonomous vehicles, the amount that we're spending does not have a B attached to it.

Mary Barra - *General Motors Company - Chairman, CEO*

I would also say, the efficiencies that we're seeing, when you can reuse architectures that we have on -- that are launching or have on the road right now, and you look at the development costs to do the next-generation architecture versus reusing, that's all, as I mentioned, investment that can be redeployed in the transformative technologies.

Joe Spak - *RBC Capital Markets - Analyst*

Okay. Thanks a lot, guys.

Operator

Thank you. I'd now like to turn the call back over to Randy Arickx.

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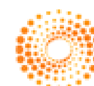

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Randy Arickx - *General Motors Company - VP Corporate Communications & IR*

I'll hand it over to Mary for closing remarks.

Mary Barra - *General Motors Company - Chairman, CEO*

Great. Thanks, everybody, for participating. I hope you can see we are working hard to make sure the core business is operating in a very disciplined fashion and we have the opportunity for continued strong performance. And that is key, because we are then investing in the transformative technologies that we've just talked about, building on our leading connectivity, building on the strong options that we have in the marketplace now and will continue to launch with the Volt, with the Bolt EV, and with other electrification products as well as our work in fuel cells.

We're being very aggressive from an autonomous perspective and leveraging the knowledge that we have to do that safely, and then also from a sharing perspective with both the alliance with Lyft and with Maven. So we understand this is an ever-challenging global marketplace but I think you -- hope that you see that we are a very focused and disciplined leadership team and we are going to continue to execute our plan and drive profitable growth.

I really appreciate everybody participating today, and I look forward to talking to you next year.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation

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