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Subject: General Motors: Reborn, High Octane SAAR and Product Play; Initiate With Overweight

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General Motors: Reborn, High Octane SAAR and Product Play; Initiate With Overweight

- We initiate coverage on GM with Overweight and a \$44 Dec-2011 price target and see the potential for significant additional appreciation beyond year-end 2011. We believe the stock offers considerable medium term product opportunity, a sound balance sheet that will delever significantly further by 2013, and high exposure to the fastest growing auto regions, balanced by still evident product/brand weaknesses in NA/Europe, an untested management, and only a few quarters of clean financials. With an ability to generate solid cash flow today despite these challenges and a near trough US SAAR, we think GM can meet these challenges and drive equity appreciation with a multi-year earnings ramp and the resultant continual delivering. Our Dec-2011 price target assumes a 4.25x EV/EBITDA multiple to our 2012 forecast, a 0.75x discount to the 5.0x we consider normalized for US auto stocks.
- High octane macro play. We believe GM is well positioned to benefit from the macro environment most likely to unfold in the coming 3-5 years: a steep cyclical rebound in the US auto region, continued rapid BRIC growth, led by China, and gradual monetary tightening. Each of the world's 10 global mass market OEMs have strong positions in either the US or BRIC, but GM uniquely stands with a #1 market share in both (including #1 in China). Further, we estimate that each 1% point rise in discount rates cuts GM's pension deficit by \$12B (+\$5/share of value).
- Product renaissance. GM's product cycle in most regions is near a trough, but it should improve within two years, and the desirability of GM's new vehicles seems noticeably improved. GM also seems to have stabilized share in its highly profitable US pickup truck segment after it took a hard hit in the wake of its bankruptcy and bailout. But GM's valuation multiple likely benefits the most if it can develop a sustainably profitable US passenger car franchise, whose revival has just begun, in our view. By 2013, it will have renewed within the past two years its entry in all four of the US's key car segments (versus only one currently).
- Cash and nothing else by 2013. GM emerged from bankruptcy with one of the industry's stronger balance sheets and management's goal is to take gross "financial liabilities" (debt + Series A preferreds + US pension deficit) to zero. Solid cash flow at current SAAR suggests GM can attain this goal by 2013 with ~\$10B/yr of FCF thereafter, offering reasonable chances of eventual multiple expansion.
- Margin runway. GM's 6.7% 2010e NA margin ex pension income has room to improve. Ford-NA, with similar labor economics, but now a largely renewed truck and car lineup, is proving the reality of 10%. We see EBITDAP of \$12.6B in 2011, \$13.8B in 2012, and \$18.1B in 2013, on a 15MM US SAAR by 2013 and flat to down US share until 2013.

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