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FEATURE

GM Gets Back in the Fast Lane

By Jack Hough February 3, 2018

PHOTO: NOAH BERGER FOR CRUISE AUTOMATION

When General Motors reports fourth-quarter financial results on Tuesday morning, robotaxi updates c
almost as much as recent profits. Whether that is justified is beside the point. Better storytelling has b
stock higher.

After all, both GM (ticker: GM) and Tesla (TSLA) are story stocks, meaning they both trade on distant ex
current income. The difference is that until recently, Tesla's story has ended in riches, and GM's, in har
extinction. First, the story has gone, car demand in the key North American market, which has been ric
too long, will drive off a cliff. Then, gradually, self-driving electric cars fetched by ride-hailing software
place of private ownership of gas guzzlers. Tesla, Uber Technologies, and the Waymo division of Alpha
will be first in line to prosper. Legacy metal-benders like General Motors won't know what hit them.

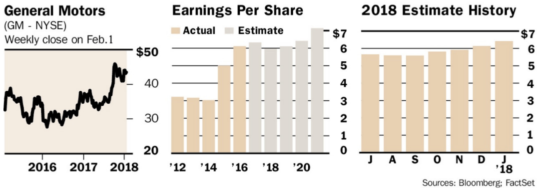
That helps explain why, a year ago, GM was the single cheapest stock in the Standard & Poor's 500 in
times forward earnings estimates, and why last April, profitless Tesla passed GM to become the bigge
maker, based on stock market value, even though GM's sales are 12 times larger.

THE STORY IS STARTING to change, however. Late last year, GM outlined an ambitious plan to intro
self-driving taxis in select cities in 2019, using what it has learned from San Francisco startup Cruise A
which it bought in 2016. Less-noticed, perhaps, than Tesla taking the market-value lead last spring, is
clawed it back, if only narrowly. Over the past six months, the old-line auto maker's stock has gained 1
for Tesla, which has struggled to ramp up production of its key Model 3 sedan. GM's market value was
billion, and Tesla's, $58 billion.

Even after its recent run, GM sells at just seven times forward earnings estimates; it was recently the f
S&P 500 stock. That creates potential for a handsome gain if GM can merely convince investors it is n
"Think of autonomous cars like a marathon at mile 17," says Barclays Capital analyst Brian Johnson. "Th
likely to come from the front pack, but not everyone in that pack will win. What is impressive about GM
suddenly joined the pack." Johnson's price target of $57 for the shares implies more than 35% upside
$41, yet includes no value for autonomous cars. Meeting the target would leave General Motors at less
projected earnings. The dividend yield is 3.7%.

On a Roll

General Motors, which reports fourth-quarter results Tuesday, has been turning in strong profits, which have helped it fund research into autonomous and electric cars. Above, a Chevrolet Bolt in the self-driving fleet being tested by GM's Cruise Automation unit.



We are under no illusions about robocars. The technology is tantalizin widespread adoption is likely many years away. Between now and the want to see exhaustive proof that self-driving cars are safer than huma The statistical bar is low; some 1.25 million people die worldwide each But a skeptical public must be won over, and when robocar glitches b fatalities, as they surely will, adoption could be held up for years, no m numbers say.

"That last 1% move toward self-driving cars might be the most difficul has ever attempted," says Morgan Stanley automotive analyst Adam Jo than landing a man on the moon and returning him safely."

That makes GM first, and primarily, a traditional car and truck maker. That's good news, because busin been better. The company's collapse during the Great Recession brought profound changes to its lab resulting in lower costs, more flexibility, and less overhang from retirement obligations.

Mary Barra, who took over as chief executive in 2014, has worked to streamline the model count, base each underlying vehicle platform, and extend the lifespan of platforms. *Barron's* added Barra to its list best CEOs last year, shortly after her company's exit from the European market, after years of losses tl quarter, all of GM's operating divisions were profitable for the first time since 2014.

ON TUESDAY, investors do not expect to learn that GM's revenues have grown. In fact, the consensus for a 16% decline from a year ago, to just under $37 billion, but for an 8% rise in earnings per share, to the revenue decline will come from leaving Europe. GM has also said it will cut production of its least-p and slow output in its most important category, North American trucks, to retool plants for significantl models to be launched later this year. Meanwhile, demand in North America has indeed peaked, althou has been modest, and the mix, favorable. In the fourth quarter, industrywide U.S. sales were down 1.5% lucrative pickup trucks were up 6.8%, according to Barclays' Johnson.

"We think the cycle is closer to a plateau than a cliff," says Edward Wojciechowski, co-manager of the & Income fund (OAKBX), which ranks near the top of its peer group for long-term performance, accord Morningstar, and recently counted GM as its second-largest holding. "Demand will come down, but no is fundamentally a truck company, which gives it a somewhat different cycle with less competition tha business." Wojciechowski says the platform investments GM has made could soon give way to a perio spending and rising free cash flow. That could create a virtuous cycle in which GM has more money to dividends, share repurchases, and pension contributions, and to invest in initiatives, including in its Au

It is too early to say who's ahead in robocars. The latest data from California testing shows that GM, w later start than Waymo, is making significant progress in closing the gap on miles driven and how man go, on average, without needing a human to take the wheel. It's unclear how even the comparison is; G demanding city environment in San Francisco, and plans to expand to Manhattan as soon as the curre Waymo is believed to be testing in less-dense areas.

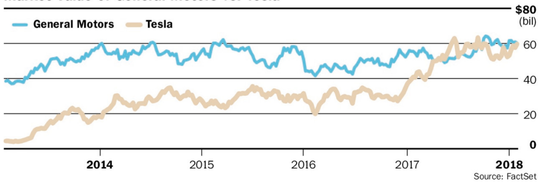
For investors, there are two key things to know about Auto 2.0. First, autonomous driving, electrificatio hailing apps might sound like separate, disruptive forces, but they're really three legs of the same stoo cheaper with drivers removed. Electric cars become more economical once they are run round the clo robotaxi services. So, it helps if a company that wants to make a play for the automotive future can do things.

GM has a long history in electric cars which includes the EV1, produced in the late 1990s, and the Volt, 2010. Don't confuse that with the current Bolt, which Car and Driver says "gives Tesla a run for its mon miles on a charge at highway speeds. In addition to GM's Cruise investment, it has spent on ride-hailin internally, via its Maven division, and externally, through a stake in Uber's rival Lyft. It also has invested (like radar, but with lasers) and batteries, and it has profitable joint ventures in China, a nation far ahea electric-car sales.

Heated Race

When Tesla's stock-market value surpassed GM's last year, it was big news in the financial media. But more recently, the big Detroit car maker quietly has edged back into the top spot.

Market Value of General Motors vs. Tesla



The second thing to know about Auto 2.0 is that although it is a long-t the current model of private car ownership, it might just prove more pı November, when GM presented its robotaxi plans to investors, it predi prices for ride-hailing fall to $1 per mile from $2 to $3 today, the servic for 20% of miles driven, versus less than 1% now, which would turn it i billion market, potentially with profit margins twice as large as GM's tc Motors can gain just a 10% share of the market by then, it could gener earnings, before interest and tax, of $19 billion, reckons Barclays' Johr compares with $12.5 billion in Ebit for GM last year. The car maker say get costs down to that $1-a-mile tipping point by the middle of the nex

MAYBE THIS IS PIE IN THE SKY, but if that is what has gotten GM stock moving in the right directior should hope for a second helping Tuesday. The key risk for General Motors in the year ahead is that th and vehicle demand deteriorates, in which case no amount of robotalk will likely impress investors. We confess that we have a history of being too bullish on the Detroit giant. Its shares have returned 15%, l what we predicted, since we recommended them a year ago ("GM Shares Could Drive 35% Higher," F

One last point on automotive disruption: there is something future-friendly about GM's current busine beefy pickups and sport utility vehicles to rural and suburban buyers. "When robotaxis come, they will cities, where GM is underrepresented," says RBC Capital analyst Joseph Spak. That gives GM a green the autonomous future, knowing that opportunities to profit will remain long after steering wheels, ga home garages have begun to disappear.

> **The Bottom Line:** Selling at just seven times forward earnings, GM shares have room to rise mor the year ahead.

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