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Honda's Bet on Self-Driving Cars Highlights Overlooked Value at GM

By Andrew Bary Oct. 3, 2018 12:00 p.m. ET

General Motors stock rose Wednesday morning. Scott Olson/Getty Images

Honda 's plan to take a stake in General Motors ' self-driving car business highlights the value inside the U.S. auto maker and could improve currently poor investor sentiment about GM.

Shares of GM were up 62 cents, or 1.8%, to $33.92 in morning trading, after gaining as much as 5.3% earlier. The stock hit a new 52-week low of $33.20 on Tuesday, falling almost $1 after the company reported an 11.1% drop in third-quarter sales. Analysts estimated that September sales were off an even steeper 15%.

Honda plans to make a $750 million investment in Cruise, GM's autonomous-vehicle division, in a deal that together with a $2.25 billion investment by Softbank Vision Fund in May values Cruise at $14.6 billion, GM said Wednesday.

Honda will get a nearly 6% stake in Cruise.

This implies that GM's roughly 75% stake in Cruise is worth $11 billion. In addition to its $750 million equity investment, Honda will contribute about $2 billion over 12 years to develop what the companies called "large-scale deployment of autonomous vehicle technology."

The Honda and Softbank investments in Cruise underscore the value of the GM self-driving car division, which is viewed as a strong No. 2 in the industry to Alphabet's Waymo unit. However, investors haven't been giving GM much credit for Cruise amid concerns about falling vehicle sales, rising commodity prices, and reduced earnings guidance.

GM expects to roll out its autonomous vehicles next year.

Investors are less excited about the Honda news than the Softbank announcement on May 31, which prompted a 12% gain in GM shares to $42.70.

That was near a high-water mark for GM, whose shares hit almost $45 in early June. The stock has been hurt in recent months by a reduction in GM's current-year profit guidance to about $6 a share from about $6.45, news that came in July in conjunction with GM's earnings release for the second quarter.

GM now trades for under six times projected 2018 earnings of $5.92 a share, one of the lowest price/earnings ratios in the S&P 500 index. The dividend yield is now about 4.6%. And the effective P/E is lower than six, excluding the value of the Cruise division, which is worth about $8 per GM share.

Investors, however, don't seem to care much about GM's asset value, its strong balance sheet, and low valuation, given concerns about declining profitability in a tough global auto market.

Car stocks globally have been under pressure and now carry the lowest P/Es of any major industry group. The major German auto makers—Daimler, BMW , and Volkswagen —now trade for six to eight times projected 2018 earnings. Ford Motor , now at about $9.20, recently hit a new 52-week low and trades at seven times estimated 2018 earnings, yielding 6.5%.

Morgan Stanley auto analyst Adam Jonas, in a client note on Tuesday, wrote that September U.S. auto sales were "very strong" at 17.4 million units on a seasonally adjusted annual rate. He noted that September sales were up against an "extremely tough" comparison in September 2017.

"The problem is the stock market appears to have written off the cycle," he wrote, which could push "management teams in new directions."

Auto stocks could be among the biggest bargains in global markets.

Write to Andrew Bary at andrew.bary@barrons.com