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Linda Hasenfratz

CEO, Linamar Corporation

MYTHS AND REALITIES ABOUT THE GLOBAL AUTOMOTIVE INDUSTRY

Chairman: **Noble Chummar**
President, The Empire Club of Canada

Head Table Guests

Verity Sylvester, Director, CV Management, and Past President, The Empire Club of Canada; Amanda Defilipis, Student, University of Guelph, Humber; Rev. Chris Miller, Retired Minister, United Church of Canada, and Chaplain, Context TV; Catherine Swift, Chair, Canadian Federation of Independent Business, and Past President, The Empire Club of Canada; Steve Weisz, Partner, Blake, Cassels & Graydon LLP; Stephen Hewitt, Senior Manager, TD Bank Group, and Director, The Empire Club of Canada; and Bliss White, Partner, Blake, Cassels & Graydon LLP.

Introduction by Noble Chummar

Our guest speaker is the inaugural speaker of our Women-in-Charge series, which will feature prominent leaders from the public and private sector at our podium. So thank you, Linda, for being here today and kicking this off.

The invention of the automobile has transformed human life. In fact, at this very podium in 1952, Henry Ford II addressed the Empire Club. He spoke of the impact of several American inventions including that of his grandfather. He said: "When you set free the creative energies of millions of individuals, you release an explosive force that performs miracles for all mankind." A Michigan farm boy set to work on the principle of mass production that gave inexpensive transportation to hundreds of millions of people.

Our guest speaker today is someone who is continuing the legacy of Mr. Ford. Linda Hasenfratz is one of the world's foremost leaders in the automotive industry. I wonder if Mr. Ford would ever have thought that a woman would take on such an important role in the industry that he created. Linda is the Chief Executive Officer of Linamar Corporation—a company founded by her father in 1966. Although she has her MBA from the Ivey Business School, she literally started her career at the bottom—having experienced life on the line as a machine operator.

Since her appointment as CEO, Linda has grown the company to over $3 billion in sales. Linamar Corporation has over 17,000 employees and operates in North America, Europe and Asia.

Linda is on the board of the Canadian Imperial Bank of Commerce and of the Royal Ontario Museum.

Ladies and gentlemen, please welcome our guest speaker, Ms. Linda Hasenfratz to the Empire Club of Canada.

Linda Hasenfratz

Thank you so much for that kind introduction. It's a real pleasure for me to be here this afternoon. I think I can safely assume that none of you were here for Henry Ford's speech, which is good. So I don't have to worry about living up to that ideal. But I hope you learn a little something about the automotive industry today. I'm here to tell you a little bit about that and also to talk about Linamar and our company and how we run our business and what we think has made us successful over the years.

I'll start off with Linamar and tell you about our company. We're a diversified manufacturing company. About two-thirds of our sales is focused on the automotive industry. The balance is made up of work we do for commercial vehicle customers on-highway, and off-highway, as well as the energy markets and the equipment market where we make scissor lifts, boom lifts and telehandlers under the brand name Skyjack.

In our automotive business, we make a variety of precision machines, components and assemblies and even full systems for

engines, transmissions, and drive-line areas of the vehicle—the same kinds of products we would be making for our commercial vehicle customers. We have had design involvement in those products increasingly as time has gone on, more on the systems side and on the drive-line side of the vehicles. So for instance, we make full all-wheel drive systems for vehicles to create all-wheel drive and improve drivability of vehicles. We would be fully design-responsible for those products, as well as doing all the manufacturing for that.

Sales last year as you heard were north of $3 billion. Being CEO of Linamar has been a very exciting opportunity that I've had over the last decade. My father started Linamar back in 1966. He named Linamar, by the way, after myself, my sister Nancy and my mother Margaret. When my sister's not around I claim the "N." I should mention that. Don't tell her. It's been a great opportunity to take something that my father started and grew so incredibly over that 25–30-year time period, and to try to be part of our continued growth. We really see just so much opportunity in each one of those different areas of our business to continue to grow the company.

My father came to Canada in the late '50s with literally nothing in his pocket, but he had a really important asset and that was a skill. He was a skilled machinist, learned his trade in his native Hungary, came here with that skill and used that skill to build this business. I mention that because I worry that our young people today are not as interested in pursuing a career in skilled trades when in actuality you can have massive success by doing that. Doing a trade is a highly lucrative career on its own, but also can be such a fantastic stepping stone to starting your own business, just like my father did, or being part of a growing and entrepreneurial company like Linamar. I look at the people who are running our plants—our general managers—and over half of them have come from the shop floor. They're either skilled trades people or operators, who showed a flair for leadership and were able to grow in our company into that position.

We've tried to build a company at Linamar with a really solid culture, a great culture centred around being entrepreneurial, being excited about growing our business, growing the top line, but also growing the bottom line, and not forgetting that that's absolutely critical in successful growth.

We're also all about balance, balanced decision making. You hear us talk quite a lot about balancing customer, employee and financial satisfaction in everything that we do and that's really critical. You hear me talk more about balance in other aspects of how we go about running our business, but that's certainly a key part of our culture at Linamar.

We are respectful—respectful of our people, respectful of the work that they do and the importance that they play in our organization. I think our people appreciate that and therefore work in accordance and that's certainly been a big part. Something my father taught me a long, long time ago is to be respectful of our people.

We're a very responsive company. We do off-highway business as well as on-highway. One of our customers, Caterpillar, is a big customer. They call us the "911 of the automotive industry" because they know if they've got a problem, they can give us a call and we can quickly help them out of their issue. I remember a situation a few years ago when Caterpillar had a plant in the southern U.S. that was unfortunately hit by a tornado and was pretty much completely destroyed. Happily, nobody was hurt, but what they realized when this incident happened, because they were fully shut down in terms of production, was that the parts that they were making in this plant actually went into almost every piece of Caterpillar equipment made worldwide. The shutdown of this one plant literally had the ability to bring this multi-billion-dollar company to its knees in a matter of weeks. They called us up and asked us how quickly we could get tooled up to make these components. Within three or four days, we had submitted our first samples and within five or six days, we were

in production and never shut Caterpillar down. I think that kind of responsiveness is really key. It's certainly what brings our customers to us and what brings them back to us. We can help them in those situations, which then, of course, brings back long-term business after that.

And lastly, we've got a culture that is absolutely grounded in innovation, hard work, and how we go about doing things. You can really see that throughout the company in terms of the products we're designing, in our drive-line business, and in the processes we design to make our products.

I talked about the idea of balance and another thing that we're always trying to balance is having the right amount of consistency and conformity in how we go about doing things—the right amount of standardization with enough independence of decision making to really encourage that innovation and ingenuity. When we have important stakeholders like our customers and our bankers pushing us for conformity, everything has to be done exactly the same because that's going to mitigate risk and allow them to be assured of a low-risk situation. I think shareholders are looking for low-risk, but I think that conformity really stifles what is a key element of success and that's innovation and ingenuity. That's why you have to strike the right balance. Pick the things that you think are really critical that you're going to dictate to everybody to utilize in running their plants, but leave enough discretion in terms of that decision making in what they're doing so that they can control outcomes and can come up with some fantastic ideas that we can share around the company. I think that that's really an important part of keeping that entrepreneurial spirit alive that is so much a part of my father and, therefore, everybody that he's touched within our organization. It certainly is something that we constantly are trying to do—simplify how we go about doing things and really let that entrepreneurial spirit thrive. I think you can crush an entrepreneur if the rulebook is too big. By the same token, they can erupt in flames if they don't have a few guidelines to work around. So we do need to mitigate risk.

I want to talk a little bit about running a successful business and some of these concepts can be applied to really any business. It doesn't even have to be manufacturing and it certainly doesn't have to be automotive.

At Linamar there are three important things that we need to focus on to have a successful and prosperous business. Number one, we need to always stay competitive. Of course, you have to be competitive in order to win business and you stay competitive by focusing on a combination of innovation and efficiency. The products that we're designing that our customers want and need to solve their problems and the designing processes need to be more efficient, have better repeatability, need to be of better quality, and we need to be faster than the next guy. This is absolutely key to competitiveness and then, of course, we have to run an absolutely efficient, lean operation. You've done a good job around planning out your line. You're must do a good job of purchasing. You must do a good job of managing your labour costs. Competitiveness, of course, is key to prosperity.

But also key is having a market of opportunity. You have to have opportunity. My father saw opportunity in the automotive business in the mid-'80s and started to really focus our organization in that area. So you have to have a good strategy where you've identified what you want to make, who you're going to make it for, how you are going to compete, and think about what people like the least about this product. What do they hate about this product or that service and how can you fix that and therefore have a real competitive advantage to get out there and take advantage of the opportunity?

And the last key is again culture—having a great, solid culture in the organization that people really understand, doing a good job of communicating with people around, and doing a good job of rewarding performance and demonstrating it at every level. I can't tell people to be entrepreneurial if I'm not acting

entrepreneurial. If my father can't do that neither can anyone else in the organization.

When I look at innovation here are a couple of examples. Process innovation is something that we've always been really good at; leading-edge machining and assembly capability and I think a great example of that is our gear business. About 10 years ago, we looked at the global gear business, which is somewhere close to $30 billion of the potential market and decided that the intricacy and the challenge around producing a gear was something that really fitted well with our strength and our capabilities, so we decided we wanted to focus on the gear market. We set up a small gear shop inside one of our plants in Guelph and today we're making more than 20 million gears a year for a variety of customers in a variety of applications. We've developed some really innovative processing around gears—helical gear grinding, leading edge stuff around processing, and that's really I think what has brought that gear business to us. We are continuing to build this innovative processing in other elements of our business.

On the product innovation side, it is important to have products that your customers need and that their customers need and a good example of that, I think, is a new product that we've just launched this year. It's an electronically actuated axle, which can turn almost any vehicle into a hybrid vehicle and give you better control and functionality around driving a vehicle. It was very well received by our customer base and we're excited about the opportunities for that business in the future. Before you ask, we haven't received an order yet, but I think it's key to have that product innovation to bring your customers to you.

Let's turn to the automotive industry and talk about what's going on in the automotive industry here in North America. This year, we're going to produce a little bit more than 16 million vehicles in North America as a whole—Mexico, Canada and the U.S. North America is the smallest of the three major global centres of North

America, Europe and Asia. We're making 16 million vehicles, a little bit less than 20 per cent, 19 per cent of global production. More than 50 per cent of global production is centred in Asia—a combination of Japan, Korea and China. China, of course, is as big as North America on its own and growing at a much, much faster rate. Europe, even with the issues that they've had economically over the last few years, is still larger than the market here in North America. It's around 22 per cent, 23 per cent of the global marketplace. We look at that and think we've grown our company to more than $3 billion focused on a market that's the smallest market in the world in terms of automotive which is about two-thirds of our business. Imagine if we can do the same thing in Asia and in Europe that we've done here in North America. Of course, a key goal for us is to globalize our business.

In terms of market share in North America, market share hasn't really shifted very much over the last five years in the major players. A few percentage points here and there but otherwise it's been pretty steady as she goes. Ford and GM are sort of neck-and-neck at between 17 and 19 per cent of the market here in North America each. Toyota is sitting at around 12 to14 per cent. Chrysler is pretty close to Toyota. They're around 10 to 12 per cent and Honda and Hyundai each have about 8 to 10 per cent of the market. So it's a pretty good split. It's not changing very much which might surprise you. I think a lot of people in the automotive industry say, "Oh, well, Toyota and Honda are dominant in the North American market," but that's not the case. Not in North America.

When you look at the global picture, Toyota is right up there vying for the number-one spot with Volkswagen. But believe me, Volkswagen has got their eye on that prize and are pushing hard to be number one. We see Volkswagen, GM and Toyota alternating in terms of their number-one position on a global basis. They would make, let's say, nine to 10 million vehicles a year each. GM maybe would make a little fewer than that. Let's say around

eight million. Renault and Hyundai also about eight million vehicles each followed by Ford at around six million.

The reason I bring this up and quote these figures for you is so that you can see the really diverse mixture on a global basis in terms of the regionality of these automakers. It's an interesting blend of the Asians, the Europeans and the Americans at each level. Volkswagen and Toyota and GM are vying for number one and then in the next round an Asian, a French and an American manufacturer. So interesting to see. It is also interesting to see the very significant position that both GM and Ford hold on a global basis because I'm often asked why do I want to do business with GM and Ford. They're not important. But they are critical players. They're critical players. They're in the top-five manufacturers globally, producing 15 to 20 million vehicles a year. Of course we're going to target doing business with those customers.

It's easy to be misled by some of the media stories you might see around what's happening with market share and I thought you might be interested in understanding what's really happening there.

I do think that production levels will increase in North America. I don't think they're going to increase dramatically in the short-term, but they will continue to increase

at a higher rate than the sales level, and the reason that I say that is I believe that we're going to see more vehicles produced in North America than are being sold here. At the moment there are still a lot of vehicles being imported into North America from either the Japanese or the Europeans. Increasingly due to higher and higher logistics costs and currency issues that have really hurt them over the last several years, they're looking to put production where they're selling the vehicles, so I think that will drive higher levels of production here in North America.

In terms of what the automakers do, I mentioned our business in the power train and drive-line areas. What I didn't mention is that 70 per cent to 80 per cent of the content in an engine and transmission is actually still manufactured by the automakers themselves. And just to give you a sense of that market, this year the market potential for engines, transmissions, drive-lines for automotives, as well as commercial vehicles, is around $400 billion. This is a massive market that is largely captive today, but is slowly being outsourced more and more to suppliers like Linamar.

We're very excited by that opportunity, because we feel that the growth for us could be significant. I think, importantly, that this will give us a consistent level of sustainable growth over a long period of time because you don't outsource $400 billion overnight. You're going to do it slowly. You're going to slowly outsource more and more of each of the content of each vehicle. As an example, I remember the 4-speed transmissions used to be pretty standard in the market in North America. We were making transmission shafts typically for the 4-speed transmissions. We would sell them for, let's say, around $12 to $15. With the 6-speed transmissions that pretty much have displaced the 4-speeds today, we would make full clutch assemblies or shaft to shell assemblies for our customers and sell them for anywhere between, let's say, $40 and $60. So this is quite an increase in terms of content potential.

In the latest transmissions that are just on the design and sourcing table right now, 9- and 10-speed transmissions, we're quoting on complex modules that are really more than one—a clutch module with additional componentry attached to it—in the neighbourhood of $100 to $120. So you can see how the content is really changing with every new transmission or every new engine. The story is similar on the engine side. More and more of the content is being outsourced, which is very, very exciting.

Offshore sourcing is on the decline and that's probably not a surprise to you. I'm sure you've heard that the amount of business being sourced in China is declining and there are a couple reasons for that. Number one is the logistics costs as mentioned. Logistics costs are certainly increasing in China at a pretty significant rate.

We have plants in China that we use for our customers in Asia and our wage inflation is around 12 per cent to 15 per cent a year compared to 2 per cent to 3 per cent here in North America. If you extrapolate those lines, you'll find that the labour costs would cross if that rate of inflation continued in between 15 and 19 years. That's tomorrow. Fifteen years from now is tomorrow. That's not even counting the increasing logistics cost. So there's a real dynamic that's changing here in terms of where product is being outsourced, and when you layer on some of the lower costs that we're seeing in North America, particularly in the U.S. on the energy side, it creates an even more compelling argument to manufacture locally instead of offshoring.

So with the manufacturing centering back into North America, I think the question becomes, "Who's going to get the production?" For instance, "Who's going to get the production of the actual vehicle?" I ask that question in the context of Canada. What's Canada's share of the pie going to be? And I worry that that piece of the pie is going to be shrinking. For us at Linamar, it doesn't matter a lot because 80 per cent to 90 per cent of what we make is shipped to the U.S. anyhow. Most of the power train plants are in the U.S. so that's where we're shipping our product. I think it matters to Canadians where vehicles are being produced because there's a huge multiplier effect of jobs. Six or seven jobs are created for every one automotive manufacturing job, so the multiplier effect is significant and the impact on the Canadian economy is significant as a result.

So how do we ensure that manufacturing of vehicles stays in Canada and what are the threats to that? Well, I think there are a couple of pretty specific threats. One is the Canadian Auto Workers (CAW). Their approach to union negotiation in comparison to the United Auto Workers (UAW) is completely different. The UAW has shown themselves to be much more flexible, agreeing to tier-two wage structures, etc. and that I think is a negative when it comes to looking at manufacturing in Canada. I think, when you couple that with the fact that many states in the U.S. are implementing right-to-work legislation, an even bigger issue for the Canadian automakers is created.

I mentioned energy costs in the U.S. are getting cheaper. We used to be at about seven cents a kilowatt hour in Canada and in the U.S. for our energy costs. Today, our energy costs at our plants in the U.S. are about five cents a kilowatt and here in Canada, they're nine or 10 cents and growing. That's rapidly going to become a significant issue, particularly for companies that have heavy energy bills.

And finally, incentives. You go into the U.S. There are huge incentive packages available in the U.S., particularly in the southern states, particularly for Original Equipment Manufacturer (OEM) assembly jobs. So I do think that these are areas that our government needs to think about and try and understand how we can ensure that the Canadian automaker jobs stay competitive. When I look at our own costs in Canada, we've been very careful and managed our costs carefully and if I look at our all-in costs in Canada compared to the U.S., it's pretty much the same. Our labour costs are slightly higher. I think they may be 8-per-cent or so higher, but are offset, thankfully, by lower taxes. Our tax rate in Canada is 25 per cent compared to 35 per cent in the U.S. It is a significant factor and actually fully offsets that labour cost differential. Our energy costs, as noted, are a little bit higher, but happily that's a smaller percentage out of sales for us. So our plants at an at-par dollar are pretty much the same from a cost perspective. You can get there. You can manage your business to get there.

I'm just going to finish off with a couple comments around technology, which I think you might be interested in again from the automotive industry perspective. There is lots of discussion and lots of interest around electric vehicles and hybrid electric vehicles in the marketplace. Most forecasts are showing that electric vehicles or the combination of electric and hybrid will probably stay less than 15 per cent of overall vehicle production

for at least the next 15 to 20 years. Pure electrics are forecast to stay a little less than 5 per cent.

The issue is that electric vehicles still need some pretty significant technology evolution to really be able to become mainstream with affordability being really the key issue here. Other issues are range of the batteries and weight of the batteries. The battery pack is 800 kilos, huge, which really puts a lot of drag on the vehicle. You know range is an issue and degradation of the battery every year is also a key issue, so we need to see some significant evolution in battery technology in order to really get electric vehicles into the mainstream.

But what I think is probably most important to understand about electric vehicles is that in a country like the U.S., they do virtually nothing for the environment. By that I mean that electricity has to come from somewhere and in the U.S., the primary source of electricity is coal fired electricity plants. MIT did a study recently that looked at the well-to-wheels emissions of a variety of different types of technologies, vehicle technologies and they found that the well-to-wheels emissions of an electric vehicle is not dissimilar to that of a diesel engine and that's just because you've shifted the emissions from the tailpipe to the coal-fired electricity plant. So although I think electric vehicles have a lot of potential once we develop the technology further, in order for it really to make a difference in the environment, we need to change where our energy is coming from and get away from the coal-fired emissions.

Some of the other things going on technology-wise in the automotive world, like making less noise because that creates friction which impacts the fuel efficiency, connectivity so vehicles talk to each other, and driverless vehicles are all really interesting technologies that are being developed today and I think they will become more and more important in the future.

So looking to the future for Linamar, we feel very, very confident, very excited about our opportunities to continue to grow our business. As I've described our market is really quite opportunistic. I feel like we've got a good strategy and a good product and a good focus around innovation to keep ourselves competitive and growing. As noted, we had $3.2 billion sales last year. We're on track for record sales this year. We have booked business by 2017 of around $4.8 billion, so that's 50-per-cent bigger than we were last year and that's in the bank. We are targeting $10 billion in the longer term and are still very confident in our ability to meet that. We want to grow in a controlled way. Double-digit growth is our minimum goal each year. We can manage that from a financial and from a people perspective and I feel very confident in our ability to achieve that.

The appreciation of the meeting was expressed by Bliss White, Partner, Blake, Cassels & Graydon LLP.