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GM - Q2 2016 General Motors Co Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the General Motors Company second-quarter 2016 earnings conference call. (Operator Instructions) As a reminder, this conference call is being recorded Thursday, July 21, 2016.

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

Randy Arickx - *General Motors Company - VP of Corporate Communications and IR*

Thanks, operator. Good morning and thank you for joining us as we review GM's financial results for the second 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 the key takeaways from each chart in the notes pages in order to provide color on the results. This morning, Mary Barra, General Motors' Chairman and Chief Executive Officer, will provide some 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 content 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 will turn the call over to Mary Barra.

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

Thanks, Randy, and good morning, everyone. Thanks for joining. I am extremely pleased to report that GM delivered strong earnings in the quarter that included record EBIT adjusted and EBIT adjusted margins in North America, record sales and strong margins in China, profitability in Europe, and records for net revenue, EBIT adjusted, EBIT adjusted margins, earnings per share diluted adjusted, and return on invested capital.

Let's take a look at the numbers. Net income increased over 150% to $2.9 billion as revenue rose 11% to $42.4 billion. EBIT adjusted was up 37% to $3.9 billion. EBIT adjusted margin was 9.3%, up from 7.5%. Earnings per share diluted adjusted was $1.86, up from $1.29. Automotive adjusted free cash flow was $3.2 billion, and we had a record ROIC of 30.5% on a trailing four-quarter basis.

This continues to demonstrate the positive impact of our disciplined capital allocation framework. Given our very strong first-half performance and our current outlook for the second part of the year, we now expect 2016 full-year EBIT adjusted to be in the range of $5.50 to $6.00 per diluted adjusted share, up from the $5.25 to $5.75 range we announced in January.

As I mentioned, our strong quarter was underpinned by outstanding performances in North America, China, and Europe. So let me just touch on those briefly. In North America we gained 0.4 percentage points of retail share in the US in the first half of the year. This is the highest of any full-line manufacturer, and I think it really indicates that our focus on more profitable sales is working. We had the best Q2 light truck retail sales in nine years and the best midsize retail pickup sales in 11 years.

Average transaction prices on full-sized pickups are up $2,700 per unit to date versus the Q2 2015 performance, and our ATPs across all models and brands are up about $1,500 per unit. Expected continued momentum in H2 will be driven by the launches of the Cruze, the Bolt EV, the LaCrosse and the Acadia, and we will also have improved availability of pickups and crossovers.

As we look at China, we are on track to sustain our strong margins this year. Our H1 sales are up 5.3% year-over-year to a record 1.8 million units, and this is really due to a great mix of MPVs and SUVs, and also luxury vehicles that customers are signaling that they really like.

Brands continue to grow. Buick and Baojun set quarterly records, with Buick up 40% and Baojun up 78% year-over-year, and our Cadillac sales are up 16% year-to-date. The GM SUV deliveries almost doubled in the quarter, and this continues to be led by two really strong products: the Baojun 560 and the Buick Envision.

In Europe the team posted its first profitable quarter since the second quarter of 2011. It was a great team effort across every single aspect of the business. Opel and Vauxhall outperformed the industry with a 7% year-over-year sales increase to 621,000 vehicles in the first half of this year, and we have more products coming in the second half with the new Zafira and the refreshed Mokka X.

In addition to the topline growth we've reviewed so far, we are also on track to exceed our target $5.5 billion in cost efficiencies by 2018, when we look at it compared to the 2014 baseline. This 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. In fact, this year alone we expect approximately $2 billion in cost performance from non-raw materials and logistics. So again, I think you can look at it and see extremely strong performance across the entire business.

We are also, as we do strong performance and continue to work to improve the core operations, we are moving very quickly to leverage our technical expertise and to lead and define the future of personal mobility with a customer focus. On the autonomous front, we completed our acquisition of Cruise Automation and we began testing self-driving Chevrolet Bolt EVs on public roads with safety drivers, and this started in the San Francisco Bay area.

Cruise provides a unique software capability, and when you take that software technology combined with our own expertise, it is really accelerating our work in fully autonomous driving.

We've also rapidly grown our shared mobility services. Maven city and residential car sharing has grown to now five markets, including New York, Ann Arbor, Chicago, Boston, and Washington, DC. And GM and the Lyft Express Drive on-demand car sharing has expanded from Chicago to Boston, Washington DC, and Baltimore. Express Drive members have driven more than 2 million miles on the platform in just four months. And they are getting to experience the quality, safety, and technology that our products and our brands have to offer. Later this year we will install Express Drive fleets in Denver, Los Angeles, and San Francisco.

Our demonstrated commitment to innovation and our autonomous work are really changing perceptions about General Motors, and helping us and specifically our Cruise Automation operations recruit the kind of talented men and women from the tech sector that we need to really increase and drive our innovation and performance.

So, in summary, we had an outstanding quarter and I am extremely proud of the team. With that, I'm going to turn it over to Chuck.

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

Thanks, Mary. I just want to take a few minutes to provide some perspective on the quarter and the first half. In addition to the outstanding second quarter that we just posted, we also had a very strong first half for the Company. EBIT adjusted results for the first half grew to $6.6 billion, up $1.6 billion on a year-over-year basis. Our EBIT adjusted margin was 8.3% in the first half, up 160 basis points year-over-year.

The positive results were broad-based with all but one of our automotive regions posting year-over-year profit improvement during the first half of the year.

To demonstrate the strength of our business over time, we have now delivered EBIT adjusted of $12.5 billion and nearly 8% margins over the last four quarters. Our strong first-half results were led by record results in North America, sustained strong performance in China, and a return to profitability in Europe.

In North America, EBIT adjusted grew to $5.9 billion for the first half, up $1 billion year-over-year. North American EBIT adjusted margins continue to be strong at 10.5%, up 80 basis points year-over-year and in line with our target of sustaining strong margins of 10% plus for the 2016 calendar year.

As an additional proof point that demonstrates the sustainability and strength of our business, North America has achieved 10% plus EBIT adjusted margins for four of the last five quarters. And over the last four quarters has delivered $12 billion in EBIT adjusted with 10.7% margins.

And fundamentally supporting our business is the US light vehicle industry that is tracking in the low to mid 17 million SAAR range year-to-date, up 1.2% compared to the same period last year. We continue to believe the industry will remain strong.

As for the rest of the world, China continues to deliver solid results with equity income of $1 billion for the first half, about equal to a year ago, and net income margins were 9.6%. However, as you all know, macroeconomic conditions in South America and many parts of our international operations continue to be challenging. The team continues to work to offset these pressures, and we will continue to take the necessary steps to set up these regions for future success.

A proof point is South America. In the first half of 2016, we narrowed losses by $170 million despite a much more challenging economic environment, fundamentally in Brazil.

Moving on to Europe, the region achieved its second straight quarter of breakeven or better results. In fact, not only was the second quarter profitable, but the region recorded EBIT adjusted of $131 million for the first half, up over $400 million on a year-over-year basis.

Of course, one of the largest uncertainties we have in Europe is the impact of the referendum in the UK, and let me provide some commentary on Brexit. Clearly things are still fluid and there are a lot of unknowns. It is important that negotiations on the UK's future relationship with the EU are concluded in a timely manner, and all businesses will certainly benefit from free movement of goods and people and continued free movement of goods and people.

Certainly we have made substantial progress toward our target to break even by taking advantage of a recovering industry cost optimization and recent launches like the Astra and Corsa. Prior to the result of the referendum, we were on track to break even for the year, as evidenced by our positive first-half performance.

The result of the vote has adversely impacted the British pound and the uncertainty has put a strain on the UK automotive industry. If current post referendum market conditions are sustained throughout the remainder of 2016, we believe it could have an impact of up to $400 million to the second half of 2016. However, it is important to note that the team remains focused on making progress on our turnaround plan in Europe.

Shifting to the balance sheet and cash flow, adjusted automotive free cash flow was $3.2 billion for the second quarter and $1.7 billion for the first half, both about equal to a year ago. Important to note that capital spending was $1.1 billion higher in the first half of this year versus 2015, as we make investments in our portfolio in line with our previously communicated plan.

Adjusted automotive free cash flow is expected to more than double in the second half of the year, and we remain very much on track to generate approximately $6 billion in adjusted automotive free cash flow for the year.

We also remain focused on investing in the business and increasing shareholder value for the long-term. As Mary discussed earlier, our strategic investments in Lyft and Cruise Automation help us to build the foundation to lead and define the future of personal mobility for our customers.

We are pleased to report that we closed on the acquisition of Cruise Automation during the second quarter. The deal consideration at closing was approximately $600 million, with $300 million paid in cash during the quarter and the remaining $300 million paid through the issuance of new common stock.

Additionally, we entered into other agreements associated with retention of key employees and performance-based awards, contingent on continued employment and/or reaching certain milestones from a technology and a commercialization perspective.

Despite nearly $800 million in cash outflows associated with our investments in Lyft and Cruise in the first half, as well as higher CapEx, our automotive cash balance increased $1.6 billion to $20.1 billion, bringing our balance back in line with our target.

Turning to our capital allocation framework, we continue to focus on driving shareholder value in the short- and long-term. We returned $1.5 billion to shareholders during the first half, including $1.2 billion in dividends and $300 million in share repurchases. Please note because of the seasonally challenging cash flow in the first quarter and our desire to get back up to our target cash level of $20 billion by the end of the second quarter, we expected that our stock buyback program would be heavily weighted to the second half of the year.

Because we are in a seasonal cash flow business, I would focus less on smaller levels of stock buybacks in a quarter and more on the overall plan. We will deliver on our commitment to buy back $5 billion of stock by the end of 2016. In fact, we intend to complete the $5 billion stockaded earlier. Given our very strong first-half performance and our current outlook for the second half of the year, we now expect 2016 full-year diluted earnings per share adjusted to be in the range of $5.50 to $6.00 per diluted adjusted share.

We expect the second half of the year to be strong but slightly below H1 results, properly due to uncertainties associated with Brexit.

As we have shown, we've accomplished a lot already this year and we are in great position for improved full-year profit and margin growth versus 2015, which would be another record year for the Company.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Rod Lache, Deutsche Bank.

Rod Lache - *Deutsche Bank - Analyst*

Good morning, everybody. Congratulations. I had a couple questions. First on North America, clearly some very strong pricing positives this quarter. I was wondering if you can comment on how we should be thinking about that for the rest of the year. And specifically what's the thinking behind the more aggressive posture on pickup incentives?

Then on Europe, presumably you've got some hedges that are offsetting the pound impact this year. So how should we be thinking about the kind of carryover effect as some of those hedges begin to roll off?

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

Thanks, Rod. Starting with North America, second-quarter strong pricing on both new launches as we expected and guided early in the year, as well as carryover pricing. And we took advantage of continued strength in trucks and SUVs. I would expect to see overall pricing moderate on a run rate basis in the second half of the year. We will continue to have strong pricing on our new product launches, but carryover pricing on a half-to-half basis will be a typical headwind.

I would talk about that in the context of, we still expect very strong performance in North America in the second half and are still driving to 10% plus margins, but that's kind of the big picture on that.

Relative to truck incentives and the incentive programs in early July, I want to make sure that is absolutely not a shift in our focus and discipline around incentives. That was nothing more than a tactic to kick off the model year 2016 selldown, as we get ready to launch both the model year 2017 trucks and SUVs as well as new products.

So that's more of a tactic versus anything else. And again, you have to look at that in the context of our expectations for the second half of the year.

On Europe relative to hedges, we did have some hedges in place that we put in place earlier this year that would cover some of the pound sterling exposure. The guidance that I provided on the second half of the year, kind of the up to $400 million headwind reflects. If the current economic conditions were to be sustained for the rest of the year -- and the biggest driver of that is really the weakness of the pound sterling -- that reflects any impact of the hedge rolloff as anything else.

So that's an all-in number right now, again, assuming that the current conditions persist through the rest of the year.

Rod Lache - *Deutsche Bank - Analyst*

Is there any carryover effect as we think about the hedges rolling off into next year? Does the impact worsen?

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

Well, look, it is early days and very uncertain. The way I think about it is in the second half of the year, again with no mitigating actions or anything else, the biggest impact is the pound sterling. That could be up to $400 million. It's roughly in the $1.30, $1.31, $1.32 range; you pick the day.

I think all other things being equal, multiplying that by 2 would be kind of a calendar year impact just looking at that specific driver.

Rod Lache - *Deutsche Bank - Analyst*

Okay. Just lastly on mobility, how should we be thinking about GM's position regarding any future investment in Lyft at this point?

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

So, Rod, I'm not going to -- there has been a lot of speculation. I'm not going to continue to speculate, but what I would say is with the Lyft alliance, it is accomplishing everything we set out for it to do. In fact, it's exceeding our expectations.

When you look at Express Drive and I talked about how we are expanding the launch, that's something that is obviously positive from a Lyft perspective, but very positive for us because it gives us an opportunity to take vehicles coming off a lease or coming off rental and put them into this, which is a better place to put the vehicles and also allows us to grow our residuals.

Also, we are very committed to being among the leaders or leading in autonomous technology. Clearly the Cruise Automation was a big piece of that, and the fact that we've already got cars on the road I think speaks to that. And we do believe that autonomous will first be tested out the marketplace in a sharing type environment, and the alliance provides us the opportunity to do that. So the alliance is delivering what we need it to.

Rod Lache - *Deutsche Bank - Analyst*

Okay, great. Thank you.

Operator

Itay Michaeli, Citi.

Itay Michaeli - *Citigroup - Analyst*

Great, thanks. Good morning, everyone. Maybe just one financial and one strategic question. First, Chuck, just on the financial side. Back to the $400 million Brexit impact, can you just kind of talk to what you are assuming for the UK and overall European auto market in the second half of the year?

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

Yes, I would say again very early days, but if I was sizing up the $400 million, I would say it's primarily the pound sterling. The UK market, our initial assessments for the second half, it could be up to a 5% to 10% reduction, but it's very, very early days. And I would say our perspective again is the largest majority of that potential impact is pound sterling related.

Itay Michaeli - *Citigroup - Analyst*

Great, then just a quick one on North America. What is the net impact from the auction sales in the quarter? It looks like it probably helped your volume delta on slide 14, but hurt the mix. Do you have a rough number of what the net of those two are?

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

Yes. I mean, obviously one of the reasons that we are executing to the retail-focused strategy is retail vehicle is more profitable than daily rent, and there's all kinds of long-term benefits which would imply daily rental are not very profitable.

As I looked across the whole EBIT bridge, I'd say it's close to a push, Itay. The favorable volume is offset by unfavorable mix and some unfavorable costs that winds its way through just the variable manufacturing associated with that. So close to a push.

Itay Michaeli - *Citigroup - Analyst*

Great. One strategic question for Mary. As you roll out the autonomous Bolt EVs in San Francisco for the testing, can you give us sort of an early sense on what the game plan is in terms of deployment of your shared level for vehicles in the Lyft network? Initially with the driver, maybe the size and the timing and magnitude of this initiative.

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

Yes. We haven't announced the exact timing because we're going to make sure as we develop the technology we are being gated by making sure that we have safe autonomous technology to put into the marketplace. We expect when we do that -- and we are working aggressively. I think the fact that we have the vehicles and we are able to so quickly integrate the Cruise Automation software into the vehicles, I think speaks to the speed at which we are moving. But we do believe it will be in a shared environment.

There will be a safety driver in the vehicle as we demonstrate with miles earned and also customer acceptance, but we haven't put specific timing or quantity on that. More to follow on that as we continue to develop the technology.

Itay Michaeli - *Citigroup - Analyst*

Okay, great. Thanks so much, everyone.

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

Thanks, Itay.

Operator

John Murphy, Bank of America Merrill Lynch.

John Murphy - *BofA Merrill Lynch - Analyst*

Good morning, guys. Just a first question on slide 14 on North America. As we look at the daily rental pressure easing in the second half of the year, is that the kind of thing that could actually become a little bit of a tailwind on a year-over-year basis as we get into early next year?

Also, sort of in the context of these vehicles that you guys will hang onto on the leasing side, I just wonder if you could talk about lease penetration in the quarter and where you can see that going and how you might deal with a much higher level of lease return in the coming years.

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

Again, I would look at all of these in the context of we are driving this business for sustainable 10% plus margins. We expect the second half to be strong like the first half was from a North American perspective. Clearly one of the benefits of cycling through (technical difficulty) is some of the challenges that we had on daily rental auction losses.

So I think that ultimately, there's a number of moving pieces in the second half, but certainly we would expect to see strong performance.

Lease penetration thus far in the first half of the year for us has run in the 28% range or so, a little bit above historical levels. We would expect to see that moderate over time. And one of the reasons that we are so focused on building Express Drive, reducing daily rental and everything else, is because we know that lease returns are going to increase, the used car market is going to normalize, and we are taking proactive actions to improve our residuals, improve our used car values for that timeframe.

John Murphy - *BofA Merrill Lynch - Analyst*

That's very helpful. Then a second question on the buybacks. We have the $5 billion commitment by the end of 2016. I'm just curious if you could just remind us where you are to date on those buybacks. And as we think about the potential to do more with the incremental $4 billion authorization, what sort of timeframe we should think about for the incremental $4 billion on top of the $5 billion?

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

Yes. So we have purchased to date $3.8 billion, as I just noted. We are committed to completing the initial share buyback of $5 billion per the committed timeline, which was the end of 2016. We will do that as quickly as possible here in 2016.

The increased authorization was through the end of 2017. Again, our capital allocation framework relatively transparent. To the extent that we are appropriately investing in the business and we maintain our $20 billion target cash in our strong balance sheet, available free cash flow will come back to shareholders. So that will be the gating on how quickly we execute the second $4 billion.

I would also point out, and I tried to make note of that in my comments, we are dealing with seasonality from a cash flow perspective. So we always need to think that share buybacks will generally be weighted towards the second half of the year versus the first half, just because of the low seasonality in the first quarter.

John Murphy - *BofA Merrill Lynch - Analyst*

Great, incredibly helpful. Then just lastly, Mary, GM has got a long track record of coming up with great technology way ahead of what is generally perceived in the market. But then the commercialization and monetization of that technology doesn't always really come through. OnStar is a great example of a product that is now gaining steam but has been around for a long time.

As you're working on all these new projects, I'm just wondering how you think about ultimately really commercializing and monetizing above and beyond what you are doing right now. It seems like you are way ahead of the curve on sort of the testing phase, but just curious how you think about commercializing and monetizing these efforts going forward.

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

Well, I think you can look across a couple technologies. First, we continue on the journey with electrification. And I think watching the Chevrolet Bolt EV later this year, getting that into the marketplace, seeing the customer reception when you really start to erase range anxiety with a 200-mile drive, 200-mile capability, and with we believe the industry's lowest sell cost. So that's something we are putting into the marketplace, capitalized on the fact that we think we have, in partnership with LG, demonstrated the cell technology -- which by the way, we own the IP for our cell chemistry -- putting that into the marketplace. And we are going to look to see how quickly that expands from an electrification perspective.

From an OnStar, agree. I think we have in the last couple years really accelerated, have a true leadership when we look at having OnStar with that connectivity across four continents. And we are continuing to look at ways to monetize that, and that's something that's accelerating.

Then with autonomous, to your point that is one of the reasons we did the Lyft alliance, is we recognized early that the fastest way to get the technology into customers' hands and to really learn and be driven by what customer expectations are is to get it into a ride-sharing fleet and get it out there.

So I think we're demonstrating different behavior with how we are getting the technology and the innovation and the technological advancements we've done into the marketplace more quickly. And I will also tell you that's something I focus on every day.

John Murphy - *BofA Merrill Lynch - Analyst*

Great, thank you very much.

Operator

Brian Johnson, Barclays.

Brian Johnson - *Barclays Capital - Analyst*

Yes, a couple of questions somewhat related. First, with kind of a soft SAAR last month, DSRs have been down on a year-over-year basis three months in a row. How are you seeing sort of the sales outlook just in terms of US SAAR for the remainder of this year and then flowing into 2017?

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

We have maintained our view that the US industry is going to remain strong in the mid-17 million kind of range through the rest of this year and kind of into next year. When we look at the leading indicators from an economic perspective and those indicators that really drive the auto SAAR, they continue to remain strong and favorable. And again, we would expect to see this improve in the second half and then continue to be strong in 2017. That's our baseline assumption, Brian.

Brian Johnson - *Barclays Capital - Analyst*

Okay. Secondly, speaking ahead to a potential eventual downturn, what is your commitment to the dividend that you are paying now? You didn't buy back stock in part, we understand, because you wanted to maintain a $20 billion cash balance, but in a downturn that might go down.

Just how committed are you to the dividends or a downturn, or would you seek to maybe limit the dividend and focus more on share buybacks?

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

I think that's a hypothetical question, Brian, because it depends on the downturn; the depth of the downturn, the perspective on the view of the downturn. Clearly, as we think about a moderate downturn and we think about our cash balance and everything else, what we would like to be able to do in a typical moderate downturn, maintain investment and maintain the dividend without drawing on the revolver.

If those are the facts and circumstances at that point, I think that would be a guiding kind of behavior or guiding tenet that you can think about, but it really depends on the facts and circumstances of the downturn.

Brian Johnson - *Barclays Capital - Analyst*

Kind of moderate, are you thinking sort of minus 10%, minus 20%, minus great recession numbers?

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

Great recession isn't moderate so I would say if you look historically and from a US perspective, a moderate downturn is 20% to 25%.

Brian Johnson - *Barclays Capital - Analyst*

Okay, so you would be willing to have cash go below $20 billion and use the balance sheet cash?

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

That's why we have it, yes. That's why we carry it.

Brian Johnson - *Barclays Capital - Analyst*

I guess when I think of your slide on investment case, and maybe this is a question more for Mary, should investors be looking at you more as an earnings growth play or more as a dividend yield investment?

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

I really think it's both. When you look at our core business that we continue to invest in, the fundamentals of having great cars, trucks and crossovers that customers are signaling they want to buy, we are segment-leading winning a lot of awards, continuing to look at how do we capitalize on adjacency, on connectivity, on GM financial. So strengthening the core businesses and growing with -- using adjacencies and also in some other key markets.

And then on top of that being very selective in the investments we are making so we can take and build on the expertise that's fundamental in this Company of integrating technology into vehicles and putting them out on the roads that potentially have the opportunity to dramatically change I'll say the current business from an earnings perspective of what that new business is worth.

So we are working on those. I would be very happy if people thought of us as delivering and doing both.

Brian Johnson - *Barclays Capital - Analyst*

Okay, thanks.

Operator

Adam Jonas, Morgan Stanley.

Neel Mehta - *Morgan Stanley - Analyst*

Good morning, everyone. This is Neel Mehta standing in for Adam Jonas. Just two questions for you.

First, taking a look at the broader industry, it seems like GM has been fairly disciplined with respect to capacity additions in North America. I wanted to get your assessment on the overall industry's discipline. Is there any concern out there that we could see pricing headwinds down the road if there's too much capacity in the industry even if SAAR remains relatively healthy and stable?

Then the second question is there's a growing concern out there regarding off-lease supply, particularly as we head into the 2018 timeframe. Can you talk about GM's potential remarketing strategy around these vehicles and could your Express Drive or Maven programs be disposition channels for off-lease vehicles in the future? Thank you.

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

Yes, thanks. Relative to industry capacity, pricing and everything else, as you look over the last number of years and just track incentive spend as a percent of transaction prices, it has inched up a little bit as we look at the trend over the last number of years, nothing alarming.

It appears that, from our perspective, the industry has continued to be rational from that perspective. Our base case is that's going to continue. As a matter of fact, one of your colleagues just wrote a research report that would indicate that the OEMs are displaying a lot of incentive discipline, and that could ultimately have a bit of a headwind from an overall SAAR perspective going forward.

So we still continue to see that. Obviously, there's puts and takes. There's always puts and takes. Strong pricing in trucks, SUVs, crossovers, and weakness in passenger cars, but by and large we continue to see overall discipline. We are certainly going to remain disciplined. We are certainly going to continue to focus on capacity utilization, hence our focus on profitable retail growth versus fleet.

Relative to off-lease supply, I think I answered that question indirectly or directly earlier. We are focusing on reducing our daily rental just to make sure that we are not adding to the used vehicle market, because that has a tendency to impact residuals which then impacts off-lease vehicles.

We have our Express Drive program which specifically we'll use vehicles that are coming from rental and/or off-lease as a supply for Lyft drivers. And we think that's going to have a pretty significant take-up. We have our factory preowned collection as well, where we are trying to go directly to customers instead of through the auction and make available a used car fleet from General Motors company cars, daily rental, etc.

All of those are really to make sure that there's good supply/demand balance looking forward, and early days but generally on track.

Neel Mehta - *Morgan Stanley - Analyst*

Great, thank you.

Operator

Colin Langan, UBS.

Colin Langan - *UBS - Analyst*

Great, thanks for taking my question. I apologize if I missed this, but any color on the purchase price for Cruise Automation and any color on the factors you're considering in making that kind of acquisition, since it's really more of a technology today?

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

Well, from a technology perspective as we look at autonomous, and Cruise Automation is a company that we have been following for a couple of years now. And as we saw the progress in a very specific technology from a, call it, machine learning or artificial intelligence, that coupled with all the work we were doing, we felt accelerated our ability to be first or among the leaders as we implement fully autonomous technology into vehicles.

So it was very specific. It was something we had been watching for quite a period of time and, strategically, we thought it was appropriate. And we did a complete make/buy analysis, but we thought the work that we had been observing would integrate very well and accelerate our efforts.

Colin Langan - *UBS - Analyst*

How much was the final price? I thought I saw some different varying headlines on it.

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

$581 million at deal.

Colin Langan - *UBS - Analyst*

Then just a follow-up, not to belabor the UK $400 million cost; that was a little bit higher than I was expecting. Are you including in there any offset from the fact that you have facilities in the UK that now have, at least in the near term, a cost tailwind as you sell into Continental Europe? Or any possible pricing offset as a lot of people in the industry will be facing challenges as you import into UK?

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

We have certainly factored in our footprint, and manufacturing footprint. The fact is we import a heckuva lot more units into the UK than we export, manufacture and export out. So we are long pound sterling.

There is very little pricing mitigation assumed in that $400 million for the balance of the year specifically because, number one, it's early days. Number two, before you can take pricing action you have to sell through inventory, and the overall inventory levels in the UK are reasonably high across all of the OEMs. And that will certainly be one of the items as we work through this and see how it develops that we will be looking at, as I'm sure other competitors will as well; as well as cost and other mitigating actions.

So primarily, as I said earlier, the $400 million looking at our overall position, primarily the weakness in the pound sterling and some industry headwind.

Colin Langan - *UBS - Analyst*

Lastly, when I'm looking at slide 14 with the North America walk, any color -- you kind of highlight in the comments that mix is mostly the rental impact. I thought with SUVs being so strong, that mix would be positive. Did that more than offset that impact?

Any color on the fixed cost and other, the $800 million, is that a run rate we should consider going forward or is just something unusual in the quarter?

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

I would say first off, mix for trucks and SUVs, this is a period-to-period adjustment. We've been in a pretty strong mix condition for the last year and a half, two years, from a truck and SUV perspective. So the year-over-year comp is relatively flat from a mix standpoint.

So I would look at this mix number as being primarily related to the daily rental volume that rolled through volume.

Fixed cost, that is very consistent with what we talked about. Incremental D&A because of our launch cadence and new investments, product launches, incremental launch costs from a marketing standpoint as we launch new products, incremental engineering again in support of our very aggressive launch cadence.

And in the second quarter, we had pretty significant manufacturing launch-related costs and manufacturing costs associated with the earthquake as we were running a lot of weekends and everything else to try to make up some of that volume.

So I would not take this $800 million and multiply it by 4 from a run rate perspective. I would expect to see fixed costs on kind of a year-over-year basis improve in the second half of the year versus the first half year-over-year.

Colin Langan - *UBS - Analyst*

Great. Thanks for taking my questions, and congrats on a good quarter.

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

Thank you.

Operator

Joseph Spak, RBC Capital Markets.

Joseph Spak - *RBC Capital Markets - Analyst*

Good morning, everyone. Thanks for taking my question. On China, I know the margin is still strong, down year-over-year. And I think you called out significant pricing pressure. It also seemed like the Baojun brand really stepped out, so that probably didn't help mix.

I was wondering, though, if you could just talk about if there's any change to the outlook there for the year. I think originally you said 2016 would be fairly flat with 2015. And then again, plans to make those margin sustainable beyond this year.

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

We have not changed our outlook for China. We continue to expect strong performance in China, equity income in the range of $2 billion, consistent with last year; margins in the 9% to 10% range.

Going forward, as we've talked about since early last year, the market is more volatile. The competition is obviously from a price perspective stepping up. We continue to believe that we can execute our plan including our product launches, improve mix from an SUV perspective, continuing efficiencies to maintain strong margins and strong equity income going forward.

I will have or we will have more to say about 2017 early next year, I would say. From where we're sitting today, we would expect to deliver the performance that we talked about earlier this year in China.

Joseph Spak - *RBC Capital Markets - Analyst*

Okay. Then, Chuck, I think you mentioned some European cost savings to be put in place to offset some of the changes from Brexit. Can you provide little bit more color there? Does that involve sort of changing the footprint? Is it sort of straight tightening the belt, or what do you have in mind?

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

Well, first -- again, I'll go back to the initial comments I made. This is early days. There's a lot of uncertainty. We wanted to size up, again based on the current economic conditions, what the impact would be for the rest of this year. And that I think, based on today's assumptions, is not a bad planning assumption.

We will look across the businesses. We have demonstrated that we would do, not only in Europe but in other parts of the world, to ensure that we are taking the actions that are necessary to drive these businesses to the kind of performance that we need to generate.

The whole laundry list, we will look to optimize channel mix in the UK. We will look to pricing, and to the extent possible price to offset any lingering FX exposure. We will look to optimize our overall cost structure, whether it's in the UK or Europe, to mitigate these things. And that may or may not involve footprint and other actions that we will take. We look to optimize our material costs.

We go through the whole list of drivers, and the team has been doing that for the last three or four years and will continue to do that. And this is another speed bump along the way, but we are just going to have to deal with it.

Joseph Spak - *RBC Capital Markets - Analyst*

Okay, then last one, sticking with Europe. I think you mentioned UK, again early stage, but could be down 5%, 10%. But based on your comment just now about the inventory levels there and how it's going to take a while for a price increase, is it possible or even likely that demand maybe gets a little bit better before it tails off?

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

I guess I'm not quite sure on your question. You mean demand from --? (multiple speakers)

Joseph Spak - *RBC Capital Markets - Analyst*

Well, if consumers wanted to get ahead of a price increase.

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

Who knows, right? I think they are probably still digesting a lot of what's going on as well. The indications I am seeing and reading, housing market has already kind of stalled a little bit over there. Consumers are sitting on their wallets. It's just very early days and something that we are going to have to monitor very closely.

Joseph Spak - *RBC Capital Markets - Analyst*

Okay, thanks. Congrats again, guys.

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

Thank you.

Operator

Ryan Brinkman, JPMorgan.

Shaon Baqui - *JPMorgan - Analyst*

This is [Shaon Baqui] on behalf of Ryan Brinkman. I have two questions. The first one is on China. You had, I mean, pretty strong margins there. But what we are also seeing is the regulators push that market towards investing and launching new energy vehicles.

So I just wanted to check with you how you're positioning your product portfolio for these incentives that are available on new energy vehicles going on a continuing basis. And also if you have any view on the extension of incentives on smaller engine vehicles in China in 2017.

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

From a new energy vehicle perspective, we already have vehicles into the marketplace, and we have a launch cadence that we plan on putting out that we will continue to expand on that, again leveraging the technology that we have, the low sell cost. So I think you will see us looking and having a comprehensive portfolio from an electrification perspective, taking advantage of the incentives and the opportunity there but also very important to meet the regulatory environment. So that is work that is well underway.

And then as it relates to the incentives.

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

Look, the announced program is through the end of 2016. Clearly we are staying engaged to the extent possible to get intelligence on whether that would be extended into 2017, or potentially terminated early. I think there's a lot of uncertainty around that point in time.

So again, we have not changed our view that it's going to come off December 31, but that is something that we closely monitor. And if there is something meaningful to report at that point in time, we will.

Shaon Baqui - *JPMorgan - Analyst*

Okay, and the second question I had is there are some early signs here emerging over the last couple of days that the midterm review for the CAFE standards, you might get some relaxation there as well with authorities, sort of acknowledging that the 2025 targets are difficult to achieve with the current mix of vehicles that are being sold.

Any updated parts there, any discussions, and is that likely to be a tailwind compared to your expectations?

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

We continue to work with the government and provide input as we do this midterm review, which I think was a very important step when the program was put in place for the new targets to have this midterm review. We clearly have identified a portfolio where we can meet, but what everyone has to remember is that it also depends on what customers actually buy. And when you look at the current environment, that drives it as well.

So I think we're going to have a good discussion as we do this interim review, but I want to reiterate we have done a lot of work to have the right portfolio. But I think we also have to make sure that the targets comprehend that customers ultimately choose what vehicles they are going to buy.

Shaon Baqui - *JPMorgan - Analyst*

Okay, great. Thanks for taking our questions. Thank you.

Operator

James Albertine, Consumer Edge Research.

James Albertine - *Consumer Edge Research - Analyst*

Great, thank you so much for taking the question. Congratulations again. I wanted to ask on South America if I may, just an update on the endgame there. It looks like you've done a great job with respect to cost controls. It seems like there's some cushion there. You've narrowed losses over time.

But it also seems at the same time that you are transforming into sort of this business of new technologies and potentially some new monetization channels. So wanted to understand the prioritization of GMSA as it relates to maybe the next sort of medium-term five-year period or so.

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

Over history, South America has been a very important business for us and has delivered strong performance. We have a very strong product portfolio there and with a lot of model-year refreshes that are happening this year that are very, I will say, economically done from a capital deployment perspective.

We have a very strong distribution network. I think the strongest dealer body when you look across the globe, the Chevrolet brand is incredibly strong. So we have a very strong core business franchise in South America, and we think the team has done a very good job over the last couple years of really looking at the market conditions, taking costs out, again on all drivers. It gets to the point that Chuck made when we were talking about Europe. We've run that play. We've demonstrated success in South America of really looking at how to take costs out and how to drive and increase from a revenue perspective.

So we see that business as important. Obviously, disappointing right now with the macroeconomic conditions that no one knows for sure how long they last, but they are lingering. But we are well-positioned and have seen improvement in the first half of this year from the first half of last year, even in a more difficult macroeconomic environment. So a very important business for us, and we know that it has huge potential as we move forward.

As it relates to technology, whether it's connectivity we've already deployed and we'll continue to grow that over the next couple of years, we will continue to also see what the receptivity is from an electrification perspective and from an autonomous perspective, but it will be customer-driven. Clearly we have the technology and the capability to do it.

James Albertine - *Consumer Edge Research - Analyst*

Great, I appreciate that color. Just two quick housekeeping items if I may as a follow-up. First, do you have any plans similar to your key peer in Ford to break out your sort of digital strategy or technology strategy as a separate segment?

Then secondly, as we are thinking about sort of fixed versus variable cost assumptions, I think Chuck alluded to this earlier. But if we're doing a breakeven analysis for the next few years in your US business, what are the right percentages to bake in now, considering all the improvements you have sort of engineered over time? Thanks so much.

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

Relative to segment reporting, we have no plans at this time to change our segment reporting. Obviously, that's something that we continuously evaluate as kind of the characteristics of the business changes. So the quick answer is no on any change to segment reporting at this time.

I'm not going to give you kind of our fixed variable perspective on a go-forward basis. I would say our real focus is to continue to maintain breakeven point in the US at a 10 million to 11 million SAAR. And that is driven by variable profit improvement and the overall level of fixed cost.

I would say importantly when you look at costs, look at North America in either the second quarter or the first half of the year, factor in what we categorize as fixed cost versus the material performance, the commercial performance; cost performance is relatively flat. And we grew our margins, which means that variable margins improved as well, and that is supportive of maintaining a low breakeven point.

So I kind of think about costs overall, both variable cost, especially the performance aspects of that, the commercial performance, against fixed cost increases.

James Albertine - *Consumer Edge Research - Analyst*

Thank you so much and best of luck in the coming quarters.

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

Thank you.

Operator

Emmanuel Rosner, CLSA.

Emmanuel Rosner - *CLSA - Analyst*

Good morning, everybody. So just a point of clarification first on, I guess, your implied guidance for the second half. When you are sort of essentially guiding to a little bit of a softer earnings in the second half, is that entirely the risk from Brexit which you quantified, or is there anything else that you're looking at? In particular, is there anything in North America sequentially?

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

Okay, first our expectations are we're going to have a very strong year. We had a very strong first half. And when I look at second half versus first half, the fundamental driver is seasonality, which is largely even pre-Brexit was a European issue. We were shut down in Europe to a large extent in the third quarter, and then there's the holidays and Brexit. Those are the two biggest factors of the second half versus first half.

North America had a great first half. We expect North America to have a great second half, continued strength. And again, our overall expectations, improved profitability year-over-year, improved margins, improved earnings-per-share, $6 billion of free cash flow, another record year. And the performance that we generated in the first half is supportive of that, and that's why we took our guidance up as well.

Emmanuel Rosner - *CLSA - Analyst*

Great, that's helpful. Then I guess on the Lyft partnership, obviously it seems off to a pretty good start. Can you share with us what sort of milestones or maybe concrete applications of the partnership we could expect over the next few years? Are there any specific things we should be looking for?

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

Well, I think when we put together the alliance, it was built on four aspects. One was we are already doing with Express Drive. Two, the power of using the vehicles that have the capability that OnStar provides, that's already underway. There is an opportunity to cross-market, and I think that's something we're just beginning to look at.

Clearly getting Lyft customers into our vehicles through Express Drive gives them exposure to the cars from a styling, from a technology, the whole value proposition that we have across our brands in GM products. And then demonstrating autonomous capability in a sharing environment. So those were the four pillars the alliance was on. As I said, those are all on track and are accomplishing exactly what we intended to do.

Emmanuel Rosner - *CLSA - Analyst*

That's great to hear, thank you.

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

Thank you.

Operator

Thank you. I would now like to turn the call back over to Mary Barra.

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

Thank you, operator. I want to thank everybody for participating on the call today. I think if you step back and look not only this quarter but what we demonstrated over the last several quarters, we really have very strong earnings power in this Company. And I think that demonstrates why GM is a compelling investment opportunity.

We know the industry well. We know what comes with challenges and twists and turns, but we also know what comes with opportunities. I think we have shown in this quarter and quarter after quarter that we have the right mindset and are holding ourselves accountable to overcome headwinds, to seize opportunities, and to meet our commitments with no excuses.

The leadership across the Company, which I'm very proud of, are pushing themselves to beat the targets we put in front of us. They want to win and they want to continue to drive value for our customers and for our owners. So we will continue to execute our plan with discipline to keep driving profitable growth, generating strong returns on invested capital, and creating shareholder value as we really focus on putting the customer at the center of everything we do.

So thanks again for your participation in our call today.

Operator

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