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DaimlerChrysler Q2 2007 Earnings Call Transcript

Question-and-Answer Session

Operator

(Operator Instructions)

Friedrich Lauer

We take the first question from Johan Grabe, please.

Johan Grabe - Deutsche Bank

Yes, good afternoon. Johan Grabe, Deutsche Bank. Three questions if I may. First of all on Mercedes on your updated margin guidance I wonder whether you could provide the framework, i.e. what currency conditions you're working with, what type of top-line growth we are going to see in that target, and what type of maybe cost cutting is built into that. I wonder whether you could share some light on that.

Secondly, in truck, within the second quarter could you outline what the main drivers were for this very positive development, cost versus maybe price in Europe for how much was the effect from that side?

And thirdly, you're probably also seen that Conti has just acquired VDO, so we are seeing a quite significant in supplier concentration in Europe. I wonder if you could share some thoughts with us with regard to future pricing in the auto industry and maybe cost cuts that you are about to go to achieve or not. Thank you.

Dieter Zetsche

Thank you very much for your questions. As far as the Mercedes Car Group is concerned, on the currency side, we are obviously on the one hand considering the short-term developments, which we all observe.

And secondly, more strategic outlook on the long-term, which we do not change, every other day but try to understand the long-term drivers, which define exchange rates. As far as top-line growth is concerned, we do see superior growth potential for the markets we are in with the Mercedes car brand verse the total passenger car market.

We obviously do see significant growth opportunities in emerging markets as was mentioned before and we do see chances for market share growth in some of the markets we are present. We do not plan on a significant further product offensive in the sense of entering significant more segments in the market than we are already present in with Mercedes, and this is due to two reasons.

First, we already in many segments and secondly, brand is our top priority, and we will not dilute the brand by any activities we should not be in line with Mercedes car brand. The cost development we very much drive by benchmark considerations, so we look at our best competitors and their developments.

Those are moving targets and try to close the gaps where they still exist as far as performance is concerned. With that set of parameters, we have our overall development of continues system of the

Mercedes Car Group. We have considered the 10% target as a very ambitious target in light of the significant investments we have to make into fuel consumption and lowering the fuel consumption. But we define it as a realistic target, ambitious but realistic, and that's why we announced it today.

Andreas Renschler

Let's come to the trucks and Andreas Renschler speaking. First of all, I think the second quarter is the first time that we could prove our strategic initiative Global Excellence and that includes, of course, our project managing the cycles.

I think it is very good market condition in Europe, better than we expected last time, this is driven mainly through economic figures in Europe, of course, but also through the eastern part of Europe where we see a very high demand.

In addition, also, like I say, international markets, like we call it, rest of world. That means sir, you asked us specifically about the cost impact, we had in our Global Excellence program a lot of initiatives for operational excellence is concerned and I think this one we can also see, so we gained a lot through our cost efficiency programs.

There is also a smaller portion of the price, it's price is concerned, it's more or less the situation that we were able in Europe to put through additional costs for the Euro-4 and Euro-5 Emission Legislation. So we were able to put it through to the customer, but mainly the effects are coming out of cost efficiency program.

This is the overall situation and if you look to Asia for a second. We had also minus 20% in the Japanese market overall, like Dr. Zetsche mentioned before, we were able to stay with the minus 4, it's driven through the international market of Fuso, mainly through new kind of version in Indonesia, Thailand, also Middle East and Africa.

We are very successful with this. So overall with this kind of effect we were able to manage that we can adequate deliver the second quarter results.

Bodo Uebber

Thanks, Andreas, as far as the announcement of today's concerns between Siemens automotive and Aconti among the different alternatives, which were in discussion. This was, from our perspective, the preferred one. Yes, it's in concentration, on the one hand, which might make it more difficult for us to deal successful with our partners in the supply industry.

On the other hand, it puts more equally based suppliers on to the table, which we appreciate, and specifically, obviously, this is now Daimler perspective, there's a good portion of the CORE automotive business of Aconti, which is a former Daimler activity where we, obviously, have very close relations with and very good cooperation, and on that basis we appreciate the decision of today.

Friedrich Lauer

Next question from Adam Jonas, please

Adam Jonas - Morgan Stanley

Hi, it's Adam Jonas from Morgan Stanley, good afternoon. Couple questions, first, specifically on pricing in North America, Zetsche, you mentioned you were able to put up pricing in Europe for Euro-4 and Euro-5 engines. But we were hearing from Pacar yesterday, there's some increasing difficulty of being able to do similar type of price increases in North American environment.

Now, that might not be so surprising given the trend in volume but are you seeing it, can you elaborate a bit on that? Are you also seeing pricing environment in the U.S. being a bit more difficult than you perhaps anticipated at the start of the year?

And also for North America in trucks, we're seeing signs that the anticipated recovery in both orders and eventually production may be pushed out a little bit more than perhaps many observers would have thought earlier in the year.

Any change on your part just with the benefit and hindsight in the last couple of months of data and discussions with your customers in the U.S. of whether that is the case as well?

And then finally, can you confirm now. And if this is done before, forgive me, but group wide, just as housekeeping, what's the FX open position now with the U.S. dollar on a post-Chrysler basis? And how much of that would be Merck versus trucks? Thank you.

Dieter Zetsche

To your question about the pricing, as I said before in a high demand situation like we have it in Europe here, it's of course easier to put such dramatic high costs for new emission regulation system through the market that we're successful year.

We anticipated a little bit an issue because the demand as, you know, in the U.S. specifically in Canada is very low for Class-8. So we said at the beginning if it's really possible to put the price through in such a market condition we were unsure from the beginning we put this in our plant, but I think we see there a kind of different situation than when the demand is starting again.

So first of all we are prepared and you are right, in the meantime, based on the low demand, there's a little bit tendency to give to the customer some more special discounts to be on a certain level.

Overall, if you're asking me when the market is coming back in the United States specifically, I think, we always said it's the end of the third quarter or the fourth quarter. The fourth quarter and this is still, I think are own aggression that I think the trend is going more or less to somewhere end of the year. I'm expecting it personally maybe at the beginning of the first quarter now. But many, what we said from the beginning, we try to be prepared for such situation, and we want to stay, and this is now I can really confirm, as a half year is over we would stay in such condition, stay profitable with Freightliner.

Adam Jonas - Morgan Stanley

Thank you.

Bodo Uebber

Adam your question to the U.S. dollar exposures, you know, that we do not disclose the total amount, but between analysts, it's analyzed synergies between \$7 billion to \$9 billion. It will increase by roughly 15% ex-Chrysler. And it is mainly related to the Mercedes-Benz, to the Mercedes Car Group. Within the Truck Group we have higher translation effect, because of course we have Freightliner in our scope. From a hedge position, I can tell you that we have more than 80% hedged ex-Chrysler for 2007, and we are over 50% hedged in 2008.

Adam Jonas - Morgan Stanley

And that was \$7 billion to \$9 billion, so we're clear?

Bodo Uebber

Yeah.

Adam Jonas - Morgan Stanley

Okay, great. Thank you very much.

Friedrich Lauer

We take the next question from Steven Cheetham, please.

Stephen Cheetham - Sanford Bernstein

Hello, it's Steve Cheetham from Sanford Bernstein. A simple question, well, two questions really. First of all, on Mercedes, the 10% you're going to be benefiting from significant positive product cycle over the next couple of years to replacing the C and E. Can you confirm whether the 10% margin target is a product cycle peak or the sort of thing you expect to be able to sustain in the medium term?

And the second very simple question, do you still expect the Chrysler deal to close as expected in the third quarter?

Dieter Zetsche

First question, the announcement is meant or the guidance is meant in the sense that later starting in 2010 we want to accomplish average sustainable level of 10% with some ups and downs related to cycles, but not a peak but an average performance level.

As far as the closing is concerned, we are completely within the anticipated time schedule for the closing and we, therefore, expect that the closing of the transaction will take place in Q3 2007 as we said all the time.

Stephen Cheetham - Sanford Bernstein

Excellent. Thank you.

Dieter Zetsche

Okay

Friedrich Lauer

Okay. Next question from John Buckland, please.

John Buckland - MS Global Securities

Good afternoon. John Buckland from we're now called MS Global Securities. I've got a question on your targets, and again, you talked about what your assumptions were in very general terms on currencies.

And you seem to imply that you didn't expect the euro to remain as strong or the dollar to remain as weak as it is. So I wonder, if you could just put some more sort of hard numbers against what your long-term assumptions are for the dollar, because obviously that's quite crucial for what Mercedes could achieve in margin terms, I guess.

Dieter Zetsche

I mean, in general terms, I would not say that we were specifically surprised by the exchange rate development, as you know, about the trading relationships between the U.S. and Asia on the one hand, and the limited adjustments being allowed in the Asian currencies and, therefore, the impact on Euro has evolved.

That has been obvious before. If we were right by \$0.01 or \$0.02 or \$0.03 it's a different question. So generally, we were, I think realistic in expectation to where we are today, and the same applies going forward without giving you a specific number on our strategic exchange rate expectations, I think it's to some extent competitive assumption. But unless something traumatic will happen we do not intend to tell you in 2012 that what we said was based on different exchange rate assumptions.

John Buckland - MS Global Securities

Okay. I'm still not really, really wiser, based on what you said. I mean would you generally have a conservative view about the dollar? I mean, the trend going as it is now, without giving anything away, you could either say we expect weakness, or we expect to base on where we are or where we've been the last year or two?

Dieter Zetsche

What I had just wanted to say is that we do expect generally continuation of weak dollar, and that in general terms we try to make our plans on conservative assumptions and not on aggressive assumptions.

John Buckland - MS Global Securities

Okay, and what about the situation on CO2, are you basing your market assumptions and the potential for selling cars in the margin potential for premium cars in Europe, is that, we talk about CO2 here.

Are you assuming that the EU will allow CO2 to achieve targets perhaps in 2015, which I think is what you see as suggesting is a more realistic target than 2012? Is that a sort of baseline?

I got the impression when listening to the Fiat conference call there still is this regard between the premium German car makers and the French and Italian small car makers about who should take the burden and how this whole CO2 issue is going to pan out.

Dieter Zetsche

Well, the ACA has agreed upon unique position on this topic. This is certainly not a given. And as a result of a number of very focused discussions, but that is where we are. And, of course we know what the requirements are at that point of time to the extent they're already defined.

And what I said before is, as I mentioned it, with awareness that we will to have meet very tough CO2 emission targets which are not exactly defined today, and that this will require us to further accelerate the pace of improving our fuel efficiency, which we have done during the last 15 years by 30%.

We will have to increase that going forward and to have invest a lot into technology and without, of course, having all the plans together by today, even not knowing what the exact requirements are, we have set the target to ourselves that in spite of those requirements, our target is 10%.

John Buckland - MS Global Securities

Okay, thank you.

Friedrich Lauer

Next question from Philippe Houchois, please.

Philippe Houchois - J.P. Morgan

Yes. Good afternoon. My question is on the truck margin in North America, and I apologize if that's been discussed. I joined the call late. But from the beginning of this planning period you were looking at, at least being breakeven in North America at the trough of the cycle.

I am just curious, if you can give us some indication how profitable you are in the region and how you're looking at Q3, production levels as I assume maybe the trough in Q3 production will be and the trough will be in Q3 and how you feel also about being in the black in the next quarter in the North American division of your truck business.

Andreas Renschler

As we said, our expectation is still that the Class-8 market will be down approximately 40% compared to last year, and we said at the beginning through all our programs like managing the cycle and efficiency programs, that includes, for example fixed cost reduction. In NAFTA operations we will stay profitable.

Philippe Houchois - J.P. Morgan

Okay. Q3, as well?

Andreas Renschler

Yes.

Philippe Houchois - J.P. Morgan

Thank you.

Friedrich Lauer

Next question from Ronald Tadross, please.

Ronald Tadross - Banc of America Securities

Thanks and good afternoon. Banc of America. Your margins are going up couple hundred basis points. How do you weigh whether or not to cut prices a little more in order to accelerate your growth versus letting the cost reductions accrue to the margin line?

Dieter Zetsche

Are you talking trucks?

Ronald Tadross - Banc of America Securities

I'm talking Mercedes. Sorry, I guess I'm trying to understand why you wouldn't cut prices a little bit and try to accelerate your growth a little bit?

Dieter Zetsche

My understanding is that we are in the business in order to make money and not to participate in any games who has the highest unit sales per year. That is not our game. We consider growth as a lever to improve our profits, and not as a target in itself.

And on that basis, we clearly have the interest to maintain our position being the Company, the car manufacturer with the highest revenues per unit, and we clearly are striving to continue to be able to sell a premium for our vehicles to our customers and, of course, at the same time, offering the customers the best deal because of the value of our vehicles, and we are not in the volume game. And we are not trying to dilute our brand with unreasonable actions in the marketplace. So we feel very comfortable with the developments we are seeing in the markets for us on both sides as far as margins are concerned and as far as volumes are concerned.

Ronald Tadross - Banc of America Securities

Okay, thanks. So how fast do you think if you look at your markets around the world I guess it's primarily the luxury markets for Mercedes, how fast do you think they're growing a year?

Dieter Zetsche³⁹

Well, we definitely do believe, and that was the track record in the past, that in the future as well, our competitive markets will grow faster than the overall markets, and as you know, they're therefore all together for the world something like in the range of 2.5% per year growth assumptions. We do believe, once again, that our market, the luxury markets are growing significantly faster.

Ronald Tadross - Banc of America Securities

Okay. Thank you. Just to clarify on the truck profits, is it possible that truck and commercial truck profits will be flat 2006 to 2007?

Andreas Renschler

We are not giving any information about it. End of August we will have -- we have the final quarter results, second quarter results, then we will give a forecast.

Ronald Tadross - Banc of America Securities

Okay. Thank you very much.

Friedrich Lauer

We take the next question from Eric Selle, please. Eric Sell from Merrill Lynch. Okay. Then we take next question from Adam Collins, please.

Adam Collins - Redburn Partners

Good afternoon. It's Adam Collins from Redburn Partners. I had a question on the development of margin at Mercedes. Could you give us a sense of to what extent that has being driven by better smart results and also lower warranty expenses and how will smart results develop, do you think, as the new model is launched in the U.S.?

Dieter Zetsche

Well, first of all, we intend and expect to deliver on our promise to not have losses with smart in 2007, and it's easy to calculate what difference that makes compared to 2006. And all together there are significant improvement on the quality side of course has shown significant impact on our cost position as far as warranty or lack of warranty cost, lack of quality costs are concerned.

Overall, the significant bigger portion of the margin improvements, were driven by cost improvements or to be specific, about 80% versus revenue that is structural improvements for the top line.

Adam Collins - Redburn Partners

Thank you.

Dieter Zetsche

You're welcome.

Friedrich Lauer

Next on the list will be Frank Biller, please.

Frank Biller - Analyst

Good afternoon, just two questions, one on the engine side on passenger cars. Maybe you can give us a glance at what engines are you bringing to the market especially talking about DeSoto side is it direct injection and how this will influence your margins.

And the other thing is the projects, which are rumored that you have together with BMW in the future, especially on, on the small car side. Maybe you can give us some hints what's going on there.

Dieter Zetsche

I didn't open my Mike. I repeat. Thanks your question as far as engines are concerned. You heard some news most recently from Mr. Carl about our development on the DeSoto side.

The idea there is to basically come up with engine which combines the virtues and benefits between a gasoline engine and the diesel engine, including the intention that you get about fuel efficiency of a diesel engine with obviously the emissions levels and kind of the cost position of the gasoline engine. And to that extent, if we can accomplish our targets there, I do certainly not see a margin deterioration based on these new engines but rather an improvement.

And as far as gasoline direct injection is concerned, I guess you refer to the second generation of those direct injecting gasoline engines, which at that point of time do carry a significantly higher cost, based on the injection system and their exhaust system, and for that reason, we will see to which extent we are able to get the pricing potential in the marketplace, which is related to the significantly better fuel efficiency of those engines. So that's an open question. This has a potential for some margin deteriorations on that basis.

You were talking about rumors, and that's what they are. We obviously heard some statements in the media, which we welcome, and we have cooperation with BMW as you know, for instance, hybrids, where we have very good experience in working together. And if we find any further opportunities in regard, we would welcome that, but there are no specific plans or decisions at that point in time.

Friedrich Lauer

Next question will be asked by Art Ellinghorst. Please.

Art Ellinghorst - Credit Suisse

It is Art Ellinghorst from Credit Suisse. If I look at your cash R&D and CapEx spending within Mercedes it appears that you're running the business currently on really industry low capital spending. Do you think that this 4% that we've seen on R&D cost and 3% on CapEx last year, that this is sustainable level or we should expect moving forward that we should see at least slight increase in your spending? Thanks.

Dieter Zetsche

Even though those numbers in comparison in the industry are the only ones available, I prefer to look more at the output than at the input. It's very easy to spend more money in any one of those fields. It's more important to get more output.

We were striving for maximizing our efficiency in those areas and I think we are making very good progress. Still, facing this significant challenge as far as emissions are concerned, and the multitude of areas where we have to further accelerate our technological strength where we do believe we are number one.

We do see some increases in absolute numbers as far as our spending in R&D is concerned and potentially as far as CapEx is concerned. If that means relative increases as well as percentages is

concerned it's not totally clear at that point in time, but certainly we have to further increase our efforts there.

We do believe that independent of the question, if it's 4% or 3.8 or 4.2%, we are in a very strong position as far as technology is concerned, as Daimler, and we have all intentions to maintain, if not further increase, this strong, if not leading position in technology in our industry.

Art Ellinghorst - Credit Suisse

Thanks a lot.

Dieter Zetsche

You're welcome.

Friedrich Lauer

We take the next question from Phillippe Barrier. Please.

Philippe Barrier - Societe Generale

Yes, good afternoon. I'm Phil Barrier from Societe Generale. I have two questions. First, regarding the Fuso situation in Japan. Can we have some view about the trend, either Japanese sales or market in 2007?

What will be the decline of the market, and Fuso in term profitability, actually what is a present level of profitability and what can we expect in Japan and in those areas due to the sales of the Cantor and the second question is regarding the Sprinter?

When will the Sprinter reach the full capacity production everywhere, and the second point, when can we get some maximum leverage on the profitability of the vans business due to the highest production of the Sprinter in the coming months?

Andreas Renschler

Let us start with truck. At Fuso we have in Japan market decrease of 22%. Many also driven through emission law change that so called Japanese 09, and in international markets, so for Fuso we could gain some volume.

So overall, we are 4% behind the first quarter, of last year. That means overall in Japan, market share development is positive. We are following, we are better compared to -- 22%, in the market share we could gain slightly better in Japan with Fuso International we are very successful.

As I said before mainly is driven through the new Cantor that we launched recently in Indonesia, Middle East and also in Africa. In that the year forecast, I can only say that we will be profitable with Fuso, and if you ask me, I'm starting to get satisfied with development in the right direction with Fuso.

Dieter Zetsche

As far as Sprinter is concerned, we have reached full capacity in Dusseldorf and Ludwigsfelde. We have started production in Argentina and the U.S., therefore in all plants we will get to full production in Argentina and the U.S. within the remainder of this year.

As far as leveraging the tremendous strength of this product margin wise in the markets, the one thing is reaching capacity, full capacity. The other one is taking the hours per vehicle down to the planned levels, which takes a little longer beyond reaching capacity, still next year we should very much be in position to leverage the full potential of the Sprinter, which is significant.

Philippe Barrier - Societe Generale

Just, what is the production expected in 2008 for the Sprinter?

Dieter Zetsche

Well, we typically do not give information about future sales.

Philippe Barrier - Societe Generale

Okay. But I don't see any installed capacities production for Fuso vehicle.

Dieter Zetsche

Our sales are very much defined by capacity. At that point in time, obviously talking about capacity about sales is the same.

Philippe Barrier - Societe Generale

Okay. Thank you.

Dieter Zetsche

You're welcome.

Friedrich Lauer

There are no further names on the list right now so therefore I will try to ask are there any further questions? Okay. Michael Shields, please go ahead with your question.

Michael Shields - Reuters

Thank you very much. Mike Shields from Reuters in Frankford. I just wanted to call because I see on my screen a story that just came up saying that Chrysler Corp has postponed the \$12 billion auto loan deal that was supposed to have in place.

I know recording Financial Services on this so it is not official but I'm wondering if there's anything you might be able to say about that? Thank you very much.

Dieter Zetsche

I'm sorry for that, but I cannot comment on this because I have to look again at the information you have. So please come back to us. I cannot comment on this.

Michael Shields - Reuters

Thank you very much.

Friedrich Lauer

Okay. There's one more question from Max Warburton, please.

Max Warburton - UBS

Good afternoon. Actually a question on the same subject. I mean, just to reiterate what the former caller asked, there's a story saying as has been rumored for a long time that the financing for the Chrysler deal is getting complex and is being postponed.

My question really is, from a Daimler manage point of view, could you help us understand how this process works? Could you just give us some clarity and reassurance that the financing is in place and that you're confident that even if servers or bankers have to pay a higher rate of debt that you're absolutely certain that that can't delay this deal? Thanks.

Dieter Zetsche

As I said before, we are completely within the anticipated time schedule for the closing. We therefore expect the closing will take place in Q3 2007 as we indicated all the time and I ask for your understanding that we cannot discuss any details in public.

Max Warburton - UBS

Thank you.

Dieter Zetsche

Thank you.

Friedrich Lauer

There's one more question from Art Ellinghorst.

Art Ellinghorst - Credit Suisse

No. Thanks a lot for taking up again. I basically had the same question as Max and Mike before. Thanks a lot. Good afternoon.

Friedrich Lauer

So obviously we have no further questions. Probably last opportunity for the day. Okay, ladies and gentlemen, thank you very much for your questions and for being with us today on the phone or on

the Internet. Corporate communications and Investor Relations remain at this post to answer any further questions you may have. We hope to see you again soon, and goodbye.

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