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TRW Tries to Show Investors Automotive Unit Is a Good Bet

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DETROIT -- As **TRW** Inc. tries to resist **Northrop Grumman** Corp.'s takeover bid, investors are sizing up how TRW's $10 billion-a-year automotive business would fare as an independent player.

TRW is hoping to win shareholder backing for a plan to spin off its TRW automotive operations as part of a broader plan to keep the company independent and focused on its faster-growing defense businesses. With a critical shareholder meeting coming up next month, TRW management needs to convince Wall Street that TRW Automotive is a buy.

TRW Automotive has going for it size -- it would be among the top 10 global automotive suppliers -- as well as diversity of customers and expertise in some critical areas of automotive technology, analysts said. With the U.S. economy rebounding, the auto sector has had a good run on Wall Street in recent months. That gives TRW and its advisers hope that a TRW Automotive spinoff would be well received now, even if the automotive unit has to emerge from its parent carrying $3 billion in debt.

"We've got some wind at our back," said one person involved in the plan. "Why shouldn't our shareholders get a piece of that upswing?"

Still, an independent TRW Automotive will face a score of challenges if its leaders hope to keep the company independent and growing over the long haul.

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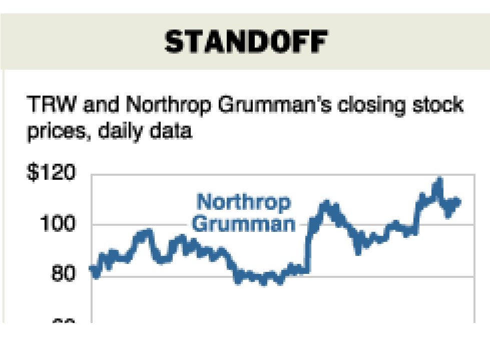

TRW Automotive's operating profit margins are hovering around 4% to 5%, compared with 9.4% in 1996. TRW Automotive's sales moved to more than $10 billion annually last year from about $6.5 billion in 1996, but profit before taxes for the unit in 2001 was $499 million, compared with $609 million five years earlier.

TRW Automotive has remained profitable throughout the recent downturn in North American automotive production and the ratcheting up of pressure from big auto makers for further price cuts from suppliers. Analysts note that TRW Automotive's profit margins exceed those of two bigger rivals, **Delphi** Corp. and **Visteon** Corp., respectively the former parts units of **General Motors** Corp. and **Ford Motor** Co.

But TRW Automotive will have to do better to get its stock moving, analysts say. TRW "will have to almost double their margins ... to 7%-8% at least to earn the cost of capital," said Scott Merlis, an analyst at Dresdner Kleinwort Wasserstein in New York.

That entails continued cost cutting, quick debt reduction and the arresting of market-share slides in its key businesses. The Cleveland-based company has already done some painful restructuring of the automotive division, closing plants and laying off thousands of employees. But analysts said the division still is moving too slowly to cut costs. "Their weakness is clearly the cost structure," said Brett Hoselton, an analyst with McDonald Investments Inc. in Cleveland, adding that there are an additional six to 12 months of aggressive restructuring ahead for TRW.

Perhaps one of the most problematic pieces of TRW Automotive is the safety-systems business. Though TRW is a No. 2 player globally in safety systems, which are primarily air bags and seat belts, Mr. Merlis at Dresdner says it trails not only the segment-leading **Autoliv** Inc. of Sweden by as much as 10% in market share, but also technologically lags behind Autoliv and even other smaller competitors, depending on products. The air-bag business, in particular, "begs the most amount of work to turn it around," said Kenneth Blaschke, a Deutsche Banc Alex Brown analyst in San Francisco.

Some analysts argued that TRW should consider selling off the safety-systems business. "If they can't achieve margins of 7%-8% in safety and earn their cost of capital, then they have to make some tough decisions here," including finding a buyer for it, said Mr. Merlis. Analysts said Delphi could be a candidate to buy TRW's safety-systems unit to compete with Autoliv.

People familiar with TRW's planning said the company may be lagging behind in the market for driver air bags but has the technology to do well in the growing market for side-impact air bags and related technologies. Further, TRW Automotive management wants to capitalize on the movement in the industry to tie together steering, braking and safety systems to create more comprehensive smart systems that, for example, monitor the stability of a vehicle, control braking to prevent skids, or in the event of a rollover use sensors that can detect the vehicle's motion to deploy side curtain air bags to protect occupants.

TRW Automotive is better positioned in other areas. One of the most promising technologies in which TRW enjoys a leading position is electric-assisted steering, as opposed to hydraulic systems to steer vehicles, which auto makers increasingly are adopting for new vehicles. Through its acquisition of automotive parts supplier Lucas Varity, in 1999, TRW gained some well-regarded management talent, including John C. Plant, who now leads TRW's automotive business. Mr. Plant "is a top-notch executive ... who can squeeze costs and create a leaner business model in a hurry," said Mr. Merlis.

Whether Mr. Plant will get a chance to lead an independent TRW Automotive will depend on whether TRW shareholders conclude that the spinoff and other features of the company's restructuring plan will deliver more value than Northrop's $47-a-share takeover bid or any competing offer that arises. Some takeover traders monitoring the situation last week viewed

TRW's spinoff plans merely as motivation for Northrop to raise its bid. TRW declined to comment in part because of Northrop's takeover bid, said Jay McCaffrey, a TRW spokesman.

So far, Northrop is sticking fast to its offer, saying that there is no reason to raise it without first taking a look at

TRW's books. But deal makers said Northrop likely will have to bump it before the April 22 special meeting in which shareholders will decide whether Northrop's takeover effort should move forward.