EUROPEAN VALUATIONS

MARKET SECTOR INSIGHTS - MAY 2019

Automotive Industry

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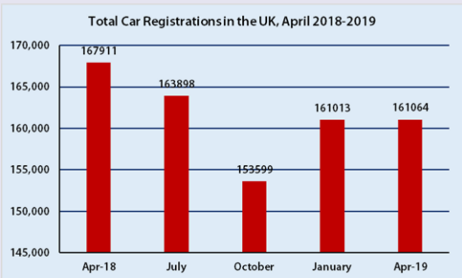

Figure 1. Total car registrations in the UK, April 2018-2019

Global Outlook

In March 2019, Moody's downgraded its 2019 auto industry outlook from stable to negative owing to falling demand. The ratings agency cut its growth forecast for worldwide light vehicle sales by more than half, saying they won't totally recover from a slowdown in the latter part of 2018. The primary reasons for this are the threat of US import tariffs and the United Kingdom's exit from the European Union along with a slowdown in global economic growth.

Moody's expects global auto sales to grow by 0.5% this year, down from its previous forecast of 1.2% "which had assumed a stronger finish in 2018." For 2020, Moody's has forecast growth of 0.8%. Auto sales are likely to continue falling in the first half of 2019, before regaining lost ground in the last two quarters of the year, Moody's said. It's forecasting a slowdown in global economic growth as well, with stronger growth in developing markets such as China. US sales are expected to drop by nearly 3% in 2019 and 0.6% in 2020, largely due to a drying up of a financing environment that had buoyed sales for so long.

UK and EU Automotive Industry Performance

Total car registrations in the UK declined 4.1% in April 2019 year-on-year from April 2018. Although some months did witness a considerable increase in car registrations, the overall trend as the figure suggests has been of a decline.

The European car market registered its seventh consecutive month of decline in March 2019. According to JATO Dynamics, ongoing political and economic uncertainty, including lack of clarity around Brexit alongside consumer preoccupation with diesel bans in cities, meant that overall demand continued to decline.

EU car registrations declined 3.2% year-on-year in Q1 2019 from Q1 2018.

Impact of Brexit on the UK Market

The automotive industry in the UK has faced and is still facing problems because of Brexit, since it might impact frictionless trade and free movement of goods between the UK and other EU nations. The primary reason for this being there is perhaps no other industry which is more tightly ingrained than the EU automotive industry.

Some Key Figures

- 51% of all exported UK-built cars were bought by customers in the European Union in 2018.
- In fact, more than 8 out of 10 passenger cars made in the United Kingdom are exported.

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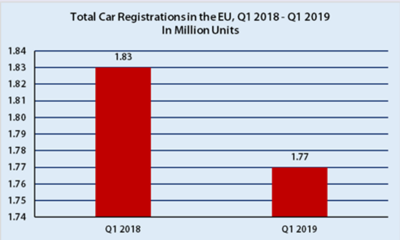

Figure 2. Total car registrations in the EU, Q12018 vis-à-vis Q12019

- The other way around, less than 4 out of 10 cars made in the EU are exported (38.3%), with roughly one third of total exports heading to the UK (or 12.4% of total production).
- The EU represents 85% of the UK's passenger car imports by volume.

To articulate it in simple terms, for the benefit of the UK automotive industry, Government must secure a future deal with the EU which guarantees frictionless trade and the free movement of goods between the UK and the EU; retains the UK's preferential trading relationships with other countries such as Japan, Canada, South Korea and Turkey; and maintains the sector's ability to access EU talent and move employees freely across sites in the UK and EU

Shift in Growth Markets

The global automotive industry's economic centre of gravity is continuing to shift, as sales volumes and market share keep moving toward emerging markets. The global sales share of established markets will decline from 50% in 2012 to 40% in 2020; these will account for only about 25% of future volume growth. The premium segment will account for more than half of future profit growth.

One major growth opportunity is in smaller vehicles (subcompacts, microcars, and superminis); these already account for more than 30% of global sales and could reach more than 30 million vehicles in 2020. More than 60% of this market is located in emerging economies, where sales are set to grow 5% to 6% per year until 2020. The majority of this growth will be in urban areas, offering OEMs the opportunity to address a large share of growth with relatively few, focused footprint adjustments. Competition in this segment, however, will be intense, as many emerging market players are expanding.

Effect of US China Trade War

The US China trade war is reverberating through the global automotive supply chain, with both US and Chinese manufacturers fearful of losing out and suffering an impact on their bottom lines. Notably, China sells few cars to the United States but is the second biggest exporter of parts to the US, after Mexico.

According to World Trade Organization figures, The US-China trade war directly affects 3% of global trade, but the automotive industry accounts for 8%. Also, this trade war is expected to have a ripple effect on other important markets as well, most notably Europe.

Autonomous Vehicle Adoption

Consumer interest in self-driving vehicles lags the pace of investment in advanced vehicle technology, according to data from the 2019 Deloitte Global Automotive Consumer Study.

Consumer trust in autonomous vehicles (AVs) appears to be stalling. In the United States, 50% of survey respondents do not believe AVs will be safe—nearly the same as last year's 47% but drastically different from 2017, when 74% voiced safety concerns. Consumer confidence in AV safety also plateaued in China, Japan, South Korea, India and Germany.

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As for Electric Vehicles (EVs), they have captured worldwide consumer interest. While 29% of US survey respondents in the survey would prefer a hybrid, battery or another alternative to traditional drive-trains for their next vehicle—up from 20% last year—low fuel prices, relaxed emissions standards and fewer rebates could dampen US EV adoption.

Tougher Fuel Norms

Recently, Honda Motor Co., Ford Motor Co., Volkswagen AG and BMW AG struck an agreement with the state of California that will push through tighter fuel-economy regulations. Other major automakers too are likely to follow the lead and implement tighter fuel-economy regulations.

Compared to the United States, Europe has always had much more ambitious fuel economy rules. Unlike two decades ago, most major markets in the world today are following Europe's lead rather than that of the United States, notable examples being China, India and Canada.

Tougher fuel norms have resulted in an increased sale of electric vehicles and adoption of lighter weight materials by almost the entire automotive industry. Going forward, such norms are expected to be one of the key reasons for major changes in the global automotive industry.

Recent Trends

European Valuations' View - Key Trends

Connected Vehicles: We have been witnessing a lot of smart technologies making their way into automobiles. One such technology is connected vehicles, which has the ability to share details about the driving conditions, such as sudden braking, speed, weather and more. Moreover, connected vehicles technology is just the beginning of what we can refer to as Vehicle to Vehicle Communication (V2V) – a technology similar to Wi-Fi, which will gradually turn out to be a standard feature on almost every vehicle. This is why topics like car sensors, vehicle transmissions and wireless communications have been in extensive discussion during the last few years.

Increasing Popularity of Crossover Vehicles: For a generation that expects the comfort of the SUV with fuel and operational cost-effectiveness, crossover vehicles have become a big hit. A mix between regular Sedans and SUVs, crossover vehicles have emerged as one of the most practical ways to commute without compromising on comfort and style. Going forward, we can expect big investments and experimentation, alongside the discovery of newer markets for these sturdy and fun crossover vehicles.

Car Sharing: Industry experts have found that, over the past few years, emotional attachment to cars has decreased significantly. This explains why car sharing has become very popular, even in emerging economies in the APAC and EMEA regions. The fact that by 2030, one out of every ten cars sold is estimated to be a shared vehicle, reflects the growing awareness to 'go green' and reduce carbon footprints. Going forward, this trend is only going to become more prominent, leading to some major upheavals amongst both consumers and manufacturers.

More Travel: PwC predicts that due to rising population figures and higher mobility demands, mileage will continue to increase. At the same time, given that driving will be easier, safer and cheaper, general mobility trends will move even more strongly in the direction of individual mobility. In addition, individual transport could become an option for groups of people who have not had access to transport at all in the past, such as people with physical disabilities. Finally, another factor here is the rise in mileage due to empty journeys made by autonomous vehicles. Therefore, it is assumed that personal mileage in Europe could rise by 23% by 2030 to 5.9 trillion kilometres, and increases could be seen of 24% in the US and up to 183% in China.

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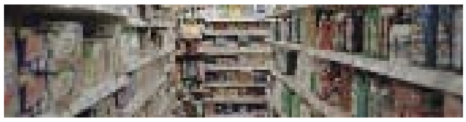

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